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COMMERCE COMMISSION

Decision No. 532

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

ABF OVERSEAS LIMITED

and

NEW ZEALAND FOOD INDUSTRIES LIMITED

The Commission:	Paula Rebstock Peter JM Taylor Denese Bates QC
Summary of Application:	The acquisition by ABF Overseas Limited of 100% of the shares in New Zealand Food Industries 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:	27 August 2004

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EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 2 August 2004. The notice sought clearance for the acquisition by ABF Overseas Limited of 100% of the shares in New Zealand Food Industries Limited. The acquisition is part of a global acquisition that will have the effect of transferring to ABF the international yeast, bakery ingredients and US herbs and spices of Burns Philp.

Market Definition

2. The Commission has found that the relevant markets for this acquisition are as follows:
   - the national market for the manufacture and wholesale supply of fresh cream and compressed yeast;
   - the upper North Island market for the manufacture and wholesale supply of packaged bread;
   - the lower North Island market for the manufacture and wholesale supply of packaged bread; and
   - the South Island market for the manufacture and wholesale supply of packaged bread.

Counterfactual

3. The Commission is of the view that the appropriate counterfactual is that NZFI would be sold to an independent party that would not raise vertical integration issues nor involve horizontal aggregation, and hence would not create a potential competition concern.

Competition Analysis

Fresh Yeast Market

4. NZFI is currently the only supplier of fresh yeast in New Zealand. Accordingly, there is no existing competition that could constrain the combined entity from exercising market power. In the past, the threat of imports has 'capped' the price of NZFI yeast.
5. The vertical integration between NZFI, as New Zealand's only fresh yeast supplier, and George Weston, through ABF, raises the concern that a substantial customer to a potential importer would no longer be available, which might make importing less attractive and therefore less likely. Consequently, with the reduced threat of imports the combined entity might be able to raise price further.
6. However, the Commission considers that in this case the vertical integration would not lead to the yeast demand of George Weston being unavailable to an importer, in addition to that of Goodman Fielder. In any case, it appears that [ ] Therefore, the Commission concludes that the threat of imports continues to cap NZFI's pricing of fresh yeast.

7. The countervailing power of customers, particularly Goodman Fielder, given its large size together with the potential availability of imports, and, to a lesser extent, supermarkets, also acts as a constraint on anti-competitive behaviour by the combined entity that may arise as a result of the vertical integration between NZFI and George Weston.

Packaged Bread Markets

8. In Decision 487 the Commission was concerned that competition in the packaged bread market might be lessened as the merged entity would have been in a position to lever its position in fresh cream yeast into that market. The Commission considers that such leveraging would not occur in the current situation relating to the vertical integration between NZFI and George Weston because:
   - the real threat of imports restrains ABF's (through NZFI) behaviour in terms of pricing, quality and continuity of supply of yeast to competitors;
   - the countervailing power of the supermarkets; and
   - ABF is unlikely to supply fresh yeast of degraded quality to competitors, or delay delivery, and risk breach of contract in relation to the supply of yeast on standard commercial terms.
9. Therefore, the Commission concludes that the vertical integration resulting from the proposed acquisition would not have, or be unlikely to have, the effect of a substantial lessening of competition in the packaged bread market.

Overall Conclusion

10. The Commission considers that the proposed acquisition would not have or be likely to have the effect of a substantial lessening of competition in the fresh yeast market or the packaged bread markets, as the threat of imports from Bakels together with the strong countervailing power of customers, particularly Goodman Fielder, and to a certain degree the supermarkets, would be a sufficient constraint to prevent the combined entity from exercising market power though the vertical integration between the baker's yeast and its bread baking operations.

THE PROPOSAL

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PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under s 66(1) 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 27 August 2004.

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 this proposed acquisition is based on principles set out in the Commission's *Merger and Acquisition Guidelines.*

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission may grant clearances for acquisitions where it is satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[1]

6. To find a substantial lessening of competition, the Commission considers that it is necessary to identify a real lessening of competition that is not minimal.[2] 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.

7. 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 able to be sustained for a period of at least two years.

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[1] *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

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

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

ANALYTICAL FRAMEWORK

9. 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).

10. 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 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

Associated British Foods Overseas Limited

11. Associated British Foods Overseas Limited (ABF) is a wholly-owned subsidiary of Associate British Foods plc (ABF plc). ABF plc is an international food ingredients and retail group based in the United Kingdom with annual sales of £4.9 billion, and over 35,000 employees. ABF plc operates businesses in four categories: grocery, primary foods and agriculture, ingredients and retail, and has manufacturing operations across Europe, North America, Asia, Australia and New Zealand. ABF is a holding company for ABF plc's various UK and overseas subsidiaries.

George Weston Foods Limited

12. George Weston Foods (NZ) Limited (George Weston) is part of the ABF plc group. George Weston's immediate parent is George Weston Foods Limited in Australia, which controls operations in New Zealand and Australia.

13. In New Zealand George Weston manufactures and distributes:
    - consumer products (baking of bread and bakery-related items; and

- ingredients and industrial products (Weston Milling – flours and bread ingredients; Jasol – cleaning and hygiene products).

14. George Weston is New Zealand's second-largest bread baker, and produces bread under brand names such as Tip Top, Burgen and Ploughmans. Its bakeries are located in Auckland, Wellington and Christchurch.

Burns, Philp & Company Limited Group

15. Burns, Philp & Company Limited Group (Burns Philp) is a manufacturer of yeast, food ingredients and consumer branded food products. It has operations in over 28 countries, and employs approximately 14,000 people. Burns Philp's product range includes bakers yeast, yeast extracts, speciality yeast products such as wine/brewers yeast, bakery ingredients and herbs and spices. Burns Philp manufactures fresh cream yeast at its plants in Sydney, Toowoomba and Auckland. Two subsidiaries of relevance to this Application are the following.

New Zealand Food Industries Limited

16. Burns Philp, through its wholly-owned subsidiary - New Zealand Food Industries Limited (NZFI) - owns the only yeast manufacturing plant in New Zealand. NZFI currently supplies all the fresh yeast requirements of New Zealand bakeries. It also manufactures speciality dry yeast (for non-baking purposes).

Goodman Fielder Group

17. Burns Philp owns 100% of the Goodman Fielder group, Australasia's largest food manufacturer, which produces well known brands, products and ingredients for the food service, commercial and industrial sectors. Goodman Fielder New Zealand's (Goodman Fielder) core divisions include Bluebird, Quality Bakers New Zealand, Champion and Meadow Lea Foods. It has an annual turnover of more that $600 million a year.

18. Through Quality Bakers the Goodman Fielder group is New Zealand's largest bread manufacturer. It produces bread under the brand names of Natures Fresh, Freyas, Vogels, Molenburg, Sunny Crust and Country Split, from bakeries located in Whangarei, Auckland, Hamilton, Rotorua, Palmerston North, Gisbourne, Napier, Wellington, Nelson, Christchurch, Dunedin and Masterton.

Bakels Group

19. The Bakels Group is a large, Swiss-based, global manufacturer and distributor of bakery and confectionary ingredients. Three Bakels entities are relevant to this investigation: Bakels-Lesaffre Yeast Pty (Bakels-Lesaffre), Australian Bakels Pty Limited (Australian Bakels) and New Zealand Bakels Ltd (NZ Bakels).

20. Bakels-Lesaffre is a joint venture owned by Societe Industrielle Lesaffre and Australian Bakels. Lesaffre, a French company, is one of the largest manufacturers of yeast and yeast products in the world. Bakels-Lesaffre manufactures fresh yeast at its plant in Victoria. It has distribution facilities for fresh cream yeast in Sydney and Perth, and has recently opened a cream yeast handling facility in Brisbane.

21. NZ Bakels manufactures and distributes a wide range of bakery ingredients, including instant active dry yeast, improvers and emulsifiers in New Zealand. NZ Bakels advised the Commission that if it were to import fresh cream yeast, it would enter into an arrangement with Bakels-Lesaffre as supplier.

OTHER RELEVANT PARTIES

Yarrows (The Bakers) Limited

22. Yarrows (The Bakers) Limited (Yarrows) is a family-owned baking business based in Manaia, Taranaki. Yarrows is New Zealand's largest independent bread maker. In addition to its branded bread lines, Yarrows is a major producer and exporter of frozen dough. It makes frozen dough for companies in New Zealand, such as Subway and Foodstuffs. Yarrows also has a bakery in Perth.

River Mill Bakeries Limited

23. River Mill Bakeries Limited (River Mill) is an independent, privately-owned bread and ingredients manufacturer based in Huntly. River Mill sells its bread products primarily through smaller retailers throughout the North Island.

Couplands Bakeries Limited

24. Coupland Bakeries Limited (Couplands) is a South Island bakery. Couplands has been in the bakery business for approximately thirty years, but has only been manufacturing bread for six years. It sells its bread products primarily through its own 18-20 retail shops in the South Island, together with other smaller retailers in the Canterbury region.

In-house supermarket bakeries

25. Both the Progressive and Foodstuffs chains have in-house bakeries in their major supermarkets. These bake a full range of breads, rolls and bagels, in both speciality and standard varieties.

Other bread shops

26. A range of hot bread shops – including franchise operations like Bakers Delight (37 stores) and Brumby's (19 stores) – operates throughout the country. These stores produce both speciality and standard breads and use a variety of forms of yeast.

INDUSTRY BACKGROUND

Yeast

27. Yeast is a living micro-organism grown through a fermentation process. After fermentation, a separation process removes excess water. Different types of yeast are used in the production of bread and other yeast-related bakery products, pizza dough bases, beer and wine. Only bakers' yeast is relevant to the proposed acquisition. Bakers' yeast is a non-substitutable ingredient used in the manufacture of bread and associated products (rolls, bagels). It performs three functions: it produces carbon dioxide gas which aerates the bread; it develops the dough through the action of fermentation on the gluten structure; and it provides flavour to the bread.

28. Continuity of supply is critical for bread manufacturers given the short shelf-life of the yeast and the daily production of bread. The frequency of fresh yeast delivery ranges from twice a day to twice a week, depending on the volume of production. The fresh yeast is transferred into storage tanks installed at the bakeries' premises, and then piped directly into vats with other ingredients and mixed into dough.

29. The bread yeast production process is outlined in diagrammatic form in Attachment 1 that process is used to produce the following types of yeast:

- **Liquid cream yeast**. This is the raw product from the manufacturing process. Liquid cream yeast is distributed directly in bulk from the manufacturing facility (NZFI) by refrigerated tanker trucks in 10,000-litre loads. To use this volume customers require storage tanks and piping systems built into the bakery. Opinion varies on the shelf-life of liquid cream yeast, and ranges from 10 days from date of delivery to 28 days from the date it leaves the factory. Liquid cream yeast is used generally by large bakeries requiring over 300 tonnes of yeast per annum. NZFI supplies liquid cream yeast to George Weston, Goodman Fielder and Yarrows for their high volume automated operations, which are specially designed to use liquid cream yeast.
- **Stabilised cream yeast**. Stabilised cream yeast is produced by adding a stabilising gum to the liquid cream yeast. Stabilised cream yeast is produced only in Australia and New Zealand. Stabilised cream yeast is sold in 1,000-litre vats. Customers require a cool room (in which the stabilised yeast is stored in the vats), and a piping system into the dough-making process. Stabilised cream yeast has a shelf-life of between 10 and 28 days. Stabilised cream yeast is generally used by medium sized bakeries requiring 100 to 200 tonnes of yeast. NZFI supplies stabilised cream yeast to such bakeries operated by George Weston, Goodman Fielder and River Mill.
- **Compressed yeast**. Compressed yeast is formed when the water from the cream yeast is removed. The resulting crumbled yeast is conveyed to the packaging operation, where it is extruded into 1kg blocks, wrapped in wax paper and refrigerated until distribution. These blocks are distributed in 18kg cartons. Customers require a cool room in which to store the compressed yeast. Compressed yeast has a shelf-life of approximately 24 days from the date of delivery. Compressed yeast is generally used by smaller bakeries, although there are instances where it is used by medium-sized bakeries (eg Quality Bakers (Dunedin), which uses **[ ]** tonnes annually). NZFI supplies compressed yeast to Goodman Fielder, George Weston, Yarrows and small bakeries (including supermarkets, hot bread shops and food ingredients wholesalers).
- **Instant Active Dry Yeast**. Instant active dry yeast is produced by feeding crumbled yeast through an extrusion process, and then a two-stage drying process, resulting in 96% dry matter. It is vacuum packed in 500gm packets, and 10 and 15kg blocks. Instant active dry yeast has a shelf-life of two years. Instant active dry yeast is different to the dry yeast used for home-baking.

30. NZFI is not able to manufacture instant active dry yeast because of its size, age and lack of suitable equipment in its manufacturing facility. However, it does

manufacture specialty dry yeasts, but these are of no relevance to the commercial bread baking industry. Previously, NZFI imported instant dry yeast (for bakeries) from Australia and Vietnam under the Mauripan brand. This part of its business – the importing as well as the distributing – has since been transferred to Champion Flour Mills (a division of Goodman Fielder).

31. The New Zealand bakers' yeast market is approximately $11 million in revenue annually. Total consumption is approximately 6,000 tonnes (compressed yeast equivalent).[3] NZFI is the only local producer of fresh yeast. Overall, NZFI manufactures and supplies approximately [ ] of bakers' yeast consumed in New Zealand, the balance being imported. Nonetheless, by comparison with other overseas yeast manufacturing plants, NZFI's operation is very small.

32. The imported yeast consumption is mainly instant dry yeast, principally from DSM, a bakery ingredient company, with some also from Bakels-Lesaffre .

33. The cost of the yeast input comprises a very small proportion of the retail price of bread – as little as 1.5% to 2.5% depending on the bread brand and price.

Bread

34. A wide variety of bread is produced in New Zealand, including packaged bread of various types, such as white, wholemeal, grain and soy, and a large variety of specialty breads.

35. The large, multi-plant industrial bakery operations of Goodman Fielder and George Weston supply packaged bread nationally via their various factories located in the main centres. Large, single plant, bakery companies supply bread to more limited geographic areas - River Mill in the North Island, Yarrows primarily in the lower North Island, and Couplands in the South Island.

36. Smaller producers such as Bakers Delight, Brumbys, supermarket instore bakeries and specialty hot bread shops primarily produce various specialty breads as well as some unpackaged cheaper breads, which are supplied on site to the store customers.

37. Most bread is sold through supermarkets. Their sales amount to approximately [ ]% of packaged bread sales, the remainder being sold through convenience stores, the route trade or in a bakery's own retail outlet. Supermarkets also retail housebrand packaged bread, which is contract baked by the major plant bakeries but sold under the supermarkets' brand names.

MARKET DEFINITION

38. The Act defines a market as:[4]

> . . . 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.

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[3] Liquid and stabilised cream yeast are supplied, in terms of volume and price, on a compressed yeast equivalent basis.

[4] S3(1) of the Commerce Act 1986.

39. 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 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.[5]

40. 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 five dimensions of a 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.

41. The Applicant submits that there are two markets relevant to this proposed acquisition:

- the national market for the supply of bakers' yeast; and
- the upper North Island, lower North Island and South Island markets for the manufacture and supply of bread.

Product Market

42. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. For each initial market so defined, the Commission considers whether the imposition of a SSNIP would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market.

43. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market. The degree of demand-side substitutability is influenced by the extent of product differentiation.

44. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

45. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

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[5] Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association*, above note 10; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

Yeast

46. The characteristics of each form of yeast are discussed more fully in the industry background section. The Applicant submits that all forms of bakers' yeast form a single market for yeast, on the basis that they all perform the same functions in the bread baking process. However, the Commission has come to the view that instant active dry yeast falls in a different market from the other three types, for the reasons now discussed.

Liquid Cream, Stabilised Cream and Compressed Yeast

47. The mixing of the liquid cream or stabilised cream yeast with the dough is automated, and controlled by computer. The dough is released into tins, and placed in a prover, before being baked in an oven.

48. There are a variety of benefits derived from this automated process:

   - precision of delivery (or avoidance of human error) leading to consistency in quality, in terms of even-sized bread;
   - shorter mixing time;
   - savings in labour requirements; and
   - a higher quality product due to no human contact.

49. Liquid and/or stabilised cream yeast is used by the large volume plant bakeries of Goodman Fielder, George Weston, Yarrows, and River Mill because of the size of their operations. Couplands is currently a compressed yeast user, [ ] Progressive also informed the Commission that it would consider switching to fresh cream yeast from compressed yeast in the future should it develop a central bread manufacturing facility.

50. Liquid cream yeast and stabilised cream yeast are different only in that the latter has a stabilised gum added. This addition means the manufacturer avoids having to mix the yeast periodically, as is required for liquid cream yeast. The industry considers the two forms of yeast are interchangeable. Given the high demand-side and supply-side substitutability, the Commission considers that liquid cream yeast and stabilised cream yeast compete in the same market.

51. Compressed yeast is packed in 1kg blocks and has to be manually unwrapped and placed in the dough mixing vat. Its form does not lend it to being used in the automated process. The mixing time and the time the yeast takes to become active is marginally longer than with liquid yeast.

52. In the past, the industry generally used compressed yeast. Between five and ten years ago the larger volume users switched from compressed yeast to liquid cream and stabilised cream due to technological advances, and the efficiencies that could be gained from an automated process.

53. The Applicant submitted that although:

> the larger bakeries have a strong preference to use cream yeast because of the size of their operations, this does not mean that, in the event of increased prices or

> reduced service (particularly quality), they would not switch to compressed yeast which performs the same function as cream yeast. All that would be required is some consequential changes to their operational processes. More particularly, this would involve customers ceasing to use their cream yeast installation systems (generally supplied by the yeast supplier in any event) and employing additional labour to unpack and add the compressed yeast to the dough mix (probably half a full-time employee). Most bakeries will already have a cool room. But if not, a cool room could be installed for as little as $50,000.

54. Most manufacturers that use cream yeast advised the Commission that while there was no functional difference between liquid cream yeast and stabilised cream yeast, on the one hand, and compressed cream yeast on the other, it would not be their preference to use compressed yeast due to the loss of efficiencies gained through the cream yeast automation process. However, most of those same manufacturers also said that if supply of cream yeast ceased, or was seriously interrupted, they would use compressed yeast. While the Commission acknowledges that technical substitution is high, the test the Commission adopts for substitutability in its competition analysis is an economic one. Accordingly, the Commission concludes that as manufacturers are unlikely to switch from fresh yeast to compressed yeast, should fresh yeast increase in price by 5-10%, there is no demand-side substitutability.

55. In terms of supply-side substitutability, the manufacturing process used to produce liquid and stabilised cream yeast is different from the process used in relation to compressed yeast. After the fermentation process in which yeast in its basic form is produced, a rotary filter drum and yeast extruder are used to produce the compressed yeast. Australian and New Zealand producers of liquid and stabilised cream yeast are also set up to produce compressed yeast, and so can switch easily from one to the other. Accordingly, there appears to be significant supply-side substitutability between liquid, stabilised and compressed yeast.

56. The Commission concludes that although there is no demand-side substitutability between the two types of cream yeast and compressed yeast, the high supply-side substitutability between liquid and stabilised cream yeast and compressed yeast, justifies placing them in the same market.

Instant Active Dry Yeast

57. Although the Commission is satisfied that instant active dry yeast and fresh yeast perform the same basic function, the degree of demand-side substitutability is influenced by differentiation between them, in terms of the efficiencies gained during the bread manufacturing process.

58. There are a variety of differences between using dry and fresh yeast in the manufacture of bread:

- considerably more manual intervention is required, particularly in relation to the necessity of reconstituting the dry yeast in a slurry, and its manual dispersement into the other bread ingredients;
- using a slurry of liquidised dry yeast can affect the consistency of bread volumes, as variations in yeast activity can mean bread volumes vary; and

- the activation time of dry yeast in the dough can take upwards of ten minutes, compared to two minutes for compressed yeast, a significant difference for the automated process.

59. Dry yeast is used by a number of "scratch" bakeries, such as the in-store bakeries in Foodstuffs Auckland, Foodstuffs Wellington and Foodstuffs South Island. But even in these cases, compressed yeast is used predominantly. Some other companies, like Bakers Delight, generally use dry yeast only as a back-up should something go wrong with their compressed yeast supply. None of the larger volume users such as Goodman Fielder, George Weston, Yarrows, River Mill and Couplands use instant active dry yeast in their operations because of the associated inefficiencies.

60. In terms of supply-side substitutability, the Commission understands that the manufacturing process used to produce instant active dry yeast is different from that used for fresh yeast. NZFI advised the Commission that it no longer produces instant active dry yeast because of NZFI's size, age and lack of suitable equipment. It said it is more economical for NZFI to import instant active dried yeast from its other plants in China and Vietnam. Given these considerations, there appears to be limited supply-side substitutability between instant active dry yeast and fresh yeast in New Zealand.

61. The Commission concludes that given the low demand-side substitutability, and the limited supply-side substitutability between instant active dry yeast and fresh yeast, instant active dry yeast forms a distinct market.

62. As instant active dry yeast does not form part of this acquisition, and therefore no aggregation issues arise, the instant active dry yeast market will not be considered further here.

Bread

63. In its Application, the Applicant cited Commission *Decision 289,* which separated specialty bread and packaged bread into different markets.[6] The Applicant submitted that developments since then show that packaged and non-packaged bread compete strongly, particularly with the proliferation of in-house supermarket bakeries and franchise bread bakers.

64. However, most industry participants the Commission consulted during its investigation were of the view that packaged bread and speciality bread continued to form discrete markets, because of their differing characteristics. Key packaged bread characteristics include: relatively low price; low margin; keeping qualities; sliced for convenience; and "neutral" taste. In contrast, key speciality bread characteristics include: relatively high price; high margin; perishability; aroma; and "interesting" taste.

65. The supermarket chains, through which most bread is sold, uniformly took the view that packaged or plant bread falls in a separate market from bread produced by in-store bakeries and hot bread shops. For example, Roger Whitfield, Retail Category Manager for Foodstuff's Auckland, New World and Four Square banners, based

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[6] Decision 297*, Goodman Fielder Limited and Defiance Mills Ltd,* April 1997.

this view on his experience that consumers' use of the two types of breads is different, in that speciality bread is purchased for a special occasion, such as a special dinner, whereas packaged bread is the basis of school lunches and toast for breakfasts.

66. The difference in price between packaged bread and specialty bread was also cited as another reason why they fall in separate markets. For example, the price of packaged bread can range from $0.99 to $3.20, whereas specialty bread loaves sold by in-store bakeries can retail for between $ 2.99 and $3.25.

67. However, the specialty bread shop, Bakers Delight, considered that its block loaf breads (which comprise 75% of its business, the other 25% being specialty breads) are in the same market as packaged breads.

68. The Commission is of the view that there appears to be a high degree of differentiation between the standard packaged loaf, and the specialty loaf from the hot bread shop or in-store bakery. This high degree of differentiation suggests that specialty and packaged bread fall into different markets. Further, applying the SSNIP test, the Commission considers that a hypothetical monopolist in the packaged bread market would be able to profitably impose a significant and non-transitory increase in price without losing a substantial volume of sales to specialty bread.

69. In terms of supply-side substitutability, the two breads require different types of ingredients, and speciality bread dough requires extra rest time. Moreover, the differences in scale in terms of manufacturing specialty and packaged bread, between small scale hot bread shops and the large automated plant bakeries, indicates very limited supply-side substitutability between packaged bread and specialty bread.

70. The Commission concludes that given the limited supply-side substitutability and low demand-side substitutability, there are two bread markets, one for "packaged" bread and the other for "specialty" bread.

71. Given that George Weston does not participate in the speciality bread market, and therefore no aggregation or vertical aggregation issues arise, it will not be considered further in this decision.

Conclusion on Product Markets

72. The Commission concludes that for the purposes of assessing the competition implications of the proposed acquisition, the appropriate product markets are the markets for:

- fresh cream and compressed bakers'yeast ; and
- packaged bread.

Functional Markets

73. The production, distribution and sale of a product typically occur through a series of functional levels, conventionally arranged vertically in descending order.

Generally, the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.

74. The Commission concludes that the relevant functional levels for the purposes of this clearance are for the manufacture and wholesale supply. Hence the relevant markets become:

- the manufacture and wholesale supply of fresh cream and compressed baker's yeast; and
- the manufacture and wholesale supply of packaged bread.

Geographic Markets

75. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

Yeast

76. NZFI prices all three forms of its yeast on a national basis. This reflects the preferences of its key customers which, despite the different locations of their bakeries, prefer uniform pricing.

77. Generally, all three forms of yeast are delivered directly by NZFI to a customers' facilities throughout New Zealand, with varying frequency.

78. In light of these various considerations, the Commission takes the geographic market to be national.

Bread

79. The geographical dimension of the bread product market is influenced by the perishability of bread, and by the cost of transporting the product long distances. Plant-baked bread stays fresh for about 18 hours before it begins to deteriorate. Long delivery trips are, therefore, undesirable because they reduce the shelf-life.[7]

80. Thus, Yarrows, whose single bakery is situated at Manaia on the southern side, sells only in Taranaki, Wanganui and Manawatu. [

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81. George Weston has plants in Auckland, Wellington and Christchurch. Goodman Fielder has plants in Whangarei, Auckland, Hamilton, Rotorua, Gisbourne, Napier, Masterton, Palmerston North, Wellington, Nelson, Christchurch and Dunedin.

82. Foodstuffs advised the Commission that the upper-lower split of the North Island and the South Island divisions reflected the division of the Foodstuffs co-operative companies in Auckland, Wellington and the South Island.

83. Although it is not possible to define the geographic market boundary precisely, the Commission is of the view that the North Island can be divided into upper and lower geographic markets.

[7] This accords with Decision 297*, Goodman Fielder Limited and Defiance Mills Ltd,* April 1997.

84. While the South Island has two main bread baking centres in Christchurch and Dunedin, there is no obvious divide which would prevent a bakery in one centre competing in the home territory of another. Couplands services the entire South Island from Christchurch. The whole of the South Island is therefore taken to be a separate geographic market.

85. Bread industry participants generally agreed with the division of the country into the three geographic markets proposed by the Applicant, and in the previous Decision 297.

86. A geographic split into three areas - north and south in the North Island, and the whole of the South Island - reflects both the way in which the plant bakeries organise their supply operations, and the east-west divide in the central North Island, which raises transport difficulties in supplying one area from the other.

87. The Commission concludes that the relevant geographic markets for the purposes of this acquisition are:

- the national market in respect of fresh yeast; and
- the upper North Island, the lower North Island, and the South Island in respect of packaged bread.

Conclusion on Market Definition

88. The Commission concludes that for the purposes of analysis of this Application, the relevant markets are :

- the national market for the manufacture and wholesale supply of fresh cream and compressed yeast (the fresh yeast market); and
- the upper North Island market, the lower North Island market, and the South Island market for the manufacture and wholesale supply of packaged bread (the packaged bread markets).

COUNTERFACTUAL AND FACTUAL

89. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison, rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[8] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

90. The Commission has been advised by the Applicant that NZFI post-acquisition would continue to operate on its existing site for a maximum of two years and then move to a new site. Some of the existing plant would be moved to the new site, but the greater part of the plant would be rebuilt. The terms of the Acquisition do not provide for any yeast supply contract between ABF and Goodman Fielder.

[8] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts Ltd/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

91. The Commission notes that the acquisition of NZFI by ABF would be unlikely to result in change of supply terms and conditions, because NZFI would continue to be a monopoly supplier in the New Zealand market regardless of the identity of the purchaser.

Counterfactual

92. Burns Philp is required to divest itself of NZFI as a condition of the Commission's clearance of Burns Philp's acquisition of Goodman Fielder. Accordingly, it can be presumed that ultimately another third party other than ABF would own NZFI. The identity of that purchaser is, however, uncertain.

93. The Commission considers that the counterfactual would involve NZFI being sold to an independent party that would not give to vertical integration (or horizontal aggregation) issues, and this would be is unlikely to create competition concerns.

COMPETITION ANALYSIS

Introduction

94. Although the acquisition would not result in any horizontal aggregation, it would raise vertical integration issues in respect of ABF owning both NZFI and George Weston. NZFI would continue to be the only domestic manufacturer of bakers' yeast, and George Weston is the second largest bread baker.

95. It is generally accepted that to have an anti-competitive effect, vertical integration must have horizontal effects, and that for such effects to occur, there must be pre-existing market power (whether unilateral or co-ordinated) at one or other of the horizontal levels involved. Anti-competitive effects may (but not necessarily will) come about because vertical integration can facilitate either the fuller exploitation, or the extension, of market power.

96. In general, vertical integration can also generate efficiency gains, although none have been claimed by the Applicant in this case.

97. In the present case, the pre-existing market power at the horizontal level occurs as a result of NZFI being the only domestic manufacturer/supplier of yeast. As a baker George Weston, the acquirer's subsidiary, is a customer. ABF owning both NZFI as a monopoly supplier and a customer raises several competition issues similar to those considered in Decision 487.

98. Decision 487 was concerned with the situation where the acquirer of Goodman Fielder, Burns Philp, was owner of NZFI, the sole supplier of fresh yeast in New Zealand. Therefore, the vertical integration concerns raised in that decision are relevant to the present situation, and these are now outlined.

99. First, the threat of imports was seen then, as now, as "capping" the price at which NZFI sold its yeast. If the merger were to make importing more difficult, competition in the fresh yeast market could be lessened. This difficulty could occur under Decision 487 as Goodman Fielder, a major buyer of yeast, would no longer be available as a customer to an importer as Goodman Fielder would be vertically integrated with NZFI. The removal of a significant customer makes it less viable

for a potential importer to import. Consequently, with the reduced threat of imports the cap currently in place would be relaxed, and NZFI would be free to raise prices further.

100. In the present case, the difference is that George Weston replaces Goodman Fielder as the vertically tied baker. However, George Weston is a significantly smaller baker that Goodman Fielder, and so the impact of its non-availability to an importer would be smaller. Indeed, this form of the vertical integration releases Goodman Fielder as a customer for a potential importer.

101. Second, competition in the packaged bread market might be lessened as the merged entity under Decision 487 would have been in a position to lever its market power in fresh cream yeast into that market. This might have been accomplished in various ways. For example, it could have supplied fresh cream yeast on terms that were relatively disadvantageous to competitors, or at a degraded quality (either in terms of the product or in the timeliness of deliveries) such that those competitors would have suffered a damaging inability to supply their product to customers. This would have enabled the merged entity unfairly to capture bread demand from its competitors.

102. Alternatively, the merged entity could use the mere threat of disruptions to the supply of an essential input as a means of enforcing an implicit cartel in bread, which would have reduced competition. By such means, competition in the packaged plant bread market could have been substantially lessened.

103. Again, in the present case, being a smaller baker than Goodman Fielder, George Weston would face a correspondingly lesser incentive to behave in these ways.

104. Having outlined those two major concerns, and answered them in broad terms, NZFI's post-merger pricing and ability to leverage market power into the packaged bread market will each be discussed in turn.

NZFI's Pricing Behaviour Post-merger

105. NZFI is currently the only supplier of fresh yeast in New Zealand. Accordingly, there is no existing competition that constrains NZFI from exercising market power, and charging whatever price it likes to customers.

106. Rather, the Applicant informed the Commission that an important determinant of the prices set by NZFI is NZFI's estimate of the price that Bakels could sell its yeast for in New Zealand (with product shipped from Australia). This behaviour is referred to in economic literature as "limit pricing." In other words, the threat of imports, or potential competition, constrains the amount of market power that NZFI can exercise, by capping the price NZFI charges for its yeast.

107. The threat of establishing a yeast plant in New Zealand could also serve to limit NZFI's pricing and constrain NZFI's market power, although this entry is highly unlikely for reasons given below.

108. Establishing and importing a yeast plant will be considered in turn.

Establishing a Yeast Plant

109. Industry participants were of the view that it would not be feasible to open a new yeast production plant capable of producing liquid and stabilised cream yeast in New Zealand, as the market is not large enough to support another plant in addition to NZFI's plant.

110. Bakels was of the view that unless there is a market that can take [ ] it would not be feasible to establish a production plant. Current demand in New Zealand is for only 6,000 tonnes a year.

111. Two of the bakeries – River Mill and Couplands – each considered self-supply by means of constructing a mini yeast plant. Both were of the view that obtaining resource management consent would be a major issue, which Couplands believed could cost as much as a third of the overall cost of the plant. They both independently came to the conclusion that a mini yeast production plant was not feasible.

112. The Commission concludes that domestic entry is not viable given the modest size of the market, the infeasibility of constructing a yeast plant, and the presence of NZFI as a domestic supplier.

Threat of Imports

113. The key issue of concern is whether NZFI's vertical integration with George Weston may somehow weaken the competitive constraint imposed by the threat of imports of yeast into New Zealand.

114. The Applicant submitted that the threat of entry rests with the ability of Bakels to import liquid yeast into New Zealand.

115. Industry participants were of the view that the only realistic source of supply of fresh yeast other than from NZFI is by means of imports. They considered that an importer would need to meet the following key requirements:

- access to a supply of fresh yeast;
- investment in a holding station, plant and equipment;
- ability to import and supply fresh yeast within its shelf-life; and
- guaranteed customers to ensure sufficient volumes.

Each of these are considered in turn.

Supply of Yeast

116. Any firm intending to enter the fresh yeast market by means of importing clearly must have access to a supply of yeast. Because of the short shelf-life of fresh yeast, the only country that would be close enough to export to New Zealand is Australia. There are two suppliers of yeast in Australia, Burns Philp and Bakels. Bakels supplies approximately 61% of the Australian fresh yeast market. Bakels is currently the only company that the Commission considers may be likely to enter the New Zealand market for reasons discussed below. It has a plant in Melbourne that currently has excess capacity. Its throughput is currently [ ] tonnes, while

its capacity is [ ] tonnes. Bakels therefore would have ready access to fresh yeast.

Investment in Plant and Equipment

117. A company importing fresh yeast would require a holding station in New Zealand. The purpose of such a station would be to receive the imported yeast in 20,000 litre tanks, from which supplies would be delivered to end-users as required. The Applicant estimates that to establish a holding station would involve an investment of approximately [ ], with an annual operating cost of [ ], excluding depreciation. Bakels already has an existing site in Auckland on which it could locate a holding station. Bakels advised that it would cost [ ] to install a holding station in Auckland, and a further [ ] to install another station in the South Island.

118. Presently, most of the equipment installed in bakeries that use fresh cream yeast, comprising refrigeration units, tanks and pumps, valves and stainless steel piping, is owned by NZFI. Therefore, new entrants might also face the additional cost in providing installation systems at customers' premises. The Applicant advised that replacement costs for a cream yeast system at George Weston is estimated to be [ ], and at Yarrow's facility to be [ ]. Goodman Fielder owns its cream yeast system. However, the practice in Australia is for a new supplier to purchase such equipment on net written-down book value basis when a customer switches supplier. It advised that the net book value is [ ] for Yarrows, [ ] for George Weston, and [ ] for Goodman Fielder.

119. Foodstuffs Auckland advised the Commission that if it were to switch to cream yeast from dry, it would prefer to install the equipment itself so as not to be bound to a particular supplier.

120. The Commission is of the view that the cost of a holding station and installing or purchasing equipment at customers' premises would not amount to a significant barrier for a company such as Bakels, given assurances over the period of supply, and the fact the incumbent is incurring such costs.

Ability to Supply Yeast within Shelf-Life

121. Liquid and stabilised cream yeast have a limited shelf-life. To be viable, an importer would have to be able to deliver the yeast to a customer within that shelf-life. Burns Philp advised the Commission that it is possible to import cream yeast and deliver it to customers within its shelf-life. It said that the cream yeast would be imported in a higher concentration (21% - 22% solids level), which lengthens the shelf-life and makes shipping it more efficient. The yeast would then be diluted at the holding station to bring it to the right concentration (17% - 18% solids level), brought to the activity specification of the customer, and delivered to the customer. Burns Philp stated that this was the process it uses to ship fresh yeast from China to Japan.

122. Burns Philp also advised the Commission that shelf-life is determined when the yeast is delivered to the customer. It said that at that point, the quality of the yeast is tested and the activity level measured. It is then passed onto the customer, at

which point the ten day shelf-life begins to run. Burns Philp explained that at this point the yeast is going into the customer's facility and is beyond the control of the supplier, and that if it were kept under the supplier's control, an even longer shelf life could be assigned.

123. Goodman Fielder pointed out that Bakels ships cream yeast from Melbourne to Perth, and would therefore be able to ship it to New Zealand. George Weston said [ ]

124. Couplands advised the Commission that it had no concerns about Bakels' expertise and ability to supply fresh yeast.

125. Bakels advised the Commission that should it enter the New Zealand market, it would import liquid cream yeast from Bakels-Lesaffre in Melbourne to its site in Auckland. [ ]

126. Bakels also confirmed it would guarantee supply to New Zealand customers. [ ]

127. Mr Farr also disagreed with the ten day shelf-life that other industry participants claim attaches to liquid cream least. He said that there is a 28 day shelf-life on fresh cream yeast from the date it leaves the factory.

128. The Commission [ ] the information received from industry participants, the Commission is of the view that the ability to import and deliver fresh yeast within its shelf-life is a low barrier, particular by a company such as Bakels that already has the distribution infrastructure.

Guaranteed Customers for Sufficient Volume

129. A central concern in Decision 487 was that Goodman Fielder, a major user of yeast, would no longer be available as a potential customer to an importer. A point of distinction partially alleviating the Commission's concerns regarding removal of a customer, is the difference in the amount of yeast used by Goodman Fielder and George Weston. George Weston's usage at [ ] is much lower than Goodman Fielder's usage at [ ].

<u>George Weston</u>

130. In Decision 487, the Commission found that Goodman Fielder would be removed as a competitor by the fact of vertical integration with NZFI. During its investigation into the present case, the Commission is satisfied that George Weston would not automatically be removed due to its vertical integration with NZFI, for the following reasons.

131. The Applicant advised that [

].

132. George Weston [

] It pointed out that ABF is run out of the UK as a separate company to George Weston in Australia and New Zealand, and accordingly NZFI would be run separately from George Weston. It stated that if NZFI did not offer it the right quality, service and price, NZFI would not get its business. It said that if NZFI tried to increase the price of yeast, George Weston would be quite free to purchase from whomsoever it wished, and it would look at alternatives.

133. The Commission considers that while it is in George Weston's interests to make such a claim, it is willing to accept there is a degree of operational separation between NZFI and George Weston on the basis of George Weston's assurances and Bakels view that George Weston would be available as customer, a point discussed more fully below.

134. George Weston also pointed out that it had been a large customer of Bakels in Australia for three years and was happy with the service. George Weston said it had no reservations about the logistics of Bakels importing fresh yeast, and would be willing to enter into a contract with it.

135. Bakels informed the Commission that it had not ruled out obtaining George Weston as a customer even if the acquisition were to go ahead. It understood that George Weston is amenable to considering different suppliers, and would deal with Bakels if it were good for them.

<u>Goodman Fielder</u>

136. The likelihood for Bakels entry is strengthened by the fact that Goodman Fielder would also be available as a potential customer.

137. Burns Philp advised the Commission that NZFI had attempted to enter into supply contracts with its customers during the sales process without success. It confirmed that there are no existing or future supply contracts with any of its customers. In a letter to the Commission, Tom Degnan, Managing Director and Chief Executive Officer of Burns Philp, said:

> I can confirm that the transaction does not provide for a long-term yeast supply agreement between NZFI and Goodman Fielder. Also, there is no arrangement or understanding that NZFI and Goodman Fielder will enter into such a long-term supply agreement upon obtained Commerce Commission clearance or generally post-transaction.

138. Goodman Fielder confirmed that it does not have any existing or intended future supply contracts with NZFI, and said that if it were not happy with NZFI it would switch and enable Bakels to enter the fresh yeast market.

139. Bakels advised the Commission that the acquisition would open up the market more for Bakels, because it made Goodman Fielder available as a customer.

<u>Other Bakers</u>

140. [ ]

141. River Mill, which has used NZFI cream yeast for six years, advised the Commission that it would prefer not to be supplied by an importer because of the need for continuity of supply. [ ].

142. Couplands, which currently uses compressed yeast, also advised that it would prefer a New Zealand-based supplier. [ ]

143. Yarrows, which primarily uses cream yeast, advised that it prefers a New Zealand supplier because of the need for continuity of supply. However, it would consider switching to Bakels if there were a price differential post-acquisition, [ ]

144. Foodstuffs Auckland said that although changing yeast supplier was not a matter to be taken lightly, because of the settled formulae for baking mixes, it would consider a proposal from Bakels if there were a need for it. Foodstuffs South Island advised that it would consider an overseas supplier if it met the necessary specifications, lead time and price.

<u>Volume</u>

145. Most bread bakers interviewed by the Commission said that in their opinion Bakels would need a supply agreement with either Goodman Fielder, which purchases [ ] of NZFI's cream yeast, or with George Weston, River Mill and Yarrows combined, in order to have sufficient volume to be able to enter the fresh yeast market. [ ]

146. As noted above, Goodman Fielder has stated that it would switch to Bakels if it were not happy with NZFI, [ ] Yarrows, Couplands and River Mill have also stated that they would switch if necessary, although individually their demands would be too small to support an importer.

Conclusion on Barriers to Entry

147. The Commission considers that the main barriers to entry in the fresh yeast market are obtaining guaranteed customers with sufficient volumes, and the ability to supply fresh yeast within its shelf-life. However, although entry is relatively difficult, and the barriers to entry are reasonably high, the Commission considers that Bakels as a potential importer has the ability to overcome them.

The "LET" Test

148. 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, sufficient in Extent and Timely (the LET test).

149. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power, and would not alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational business would be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

150. If it is to constrain market participants, the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner.

151. If it is to alleviate concerns about a substantial lessening of competition, entry must be feasible within a reasonably short timeframe, considered to be two years, from the point at which market power is first exercised.

152. There is [ ], that Bakels intends to enter the New Zealand fresh yeast market provided it can obtain sufficient customers to make entry viable. [ ]

153. Industry participants spoken to considered that Bakels has the ability to enter to a sufficient extent and in a sufficiently timely manner to constrain the combined firm from exercising market power. They all were of the view that there had been no evidence of NZFI exercising market power in the form of increasing prices or reducing quality or service, despite being the sole supplier in New Zealand, and that this had been because of the threat of Bakels importing fresh yeast as an alternative to NZFI. This has remained the case in the previous 18 months while NZFI has been under the control of Burns Philp.

154. Goodman Fielder, for example, said that NZFI knows there are alternatives, and that NZFI was aware that if Goodman Fielder were not happy with them and switched to Bakels, [ ]

155. As discussed above, if the combined entity attempted to exercise market power, particularly by reducing quality or interrupting continuity of supply, Bakels would be likely to be able to obtain supply contracts for a sufficient quantity to be able to enter to a sufficient extent to exercise constraint on any such attempt to exercise market power.

156. Bakels advised the Commission that once it had obtained supply contracts for sufficient volume, it would be able to enter the fresh yeast market within six months, [ ].

157. It should be noted that industry participants such as Goodman Fielder, George Weston, Yarrows, River Mill and Couplands were of the view that the threat of Bakels entering would continue to prevent the combined entity from exercising market power.

158. The Commission, based on the information gathered and the views of industry participants spoken to, is of the view that should NZFI attempt to exercise market power post-acquisition, bakers would switch their yeast demand to Bakels which would be likely to enter the fresh yeast market to a sufficient extent and in a sufficiently timely manner to constrain NZFI.

Conclusion on Threat of Imports

159. The Commission considers that the barriers to entry are reasonably significant, but that Bakels would be able to overcome them.

160. The Commission also considers that the competitive constraint imposed on the combined entity by way of threat of imports would not be weakened due to this merger. The central reason for this conclusion is that both George Weston and Goodman Fielder would be available as potential customers, overcoming a key concern on this point in Decision 297.

Countervailing Power

161. The Applicant submitted that NZFI would be reliant post-acquisition on ongoing purchases by Goodman Fielder and Yarrows to utilise capacity and maintain efficiencies, given that George Weston's demand for bakers' yeast amounts to only [ ] of the total. It stated that NZFI would need the throughput to maintain profitability, so that it would be counter-intuitive for it to raise prices and risk the possibility of Goodman Fielder switching to Bakels.

162. The Commission notes that Goodman Fielder's, Yarrow's and George Weston's usage amounts to over [ ], and therefore the Applicant is perhaps overstating NZFI's reliance on all three companies' custom. The Commission considers that to remain profitable, NZFI would need either Goodman Fielder alone, or George Weston and Yarrows together.

163. The Applicant also submitted that Goodman Fielder would have the ability to exercise countervailing power arising from its trans-Tasman position, given the importance to Burns Philp Australia of Goodman Fielder's yeast purchasing business, [ ]. Burns Philp advised the Commission that in November 2000 Burns Philp lost a large Goodman Fielder contract to Bakels. It then lost all its George Weston business in NSW of [ ] to Bakels, illustrating that customers are prepared to switch suppliers. Burns Philp said that if NZFI lost its Goodman Fielder business in New Zealand its business would become marginal.

164. The Applicant pointed out that NZFI is currently supplying Goodman Fielder, George Weston and Yarrows, and it could be expected, especially with the increasing threat of imports from Bakels, that NZFI would continue to fight hard to continue to supply these customers post-acquisition.

165. The Applicant supplied a report from Charles River Associates that contained a table, reproduced here as Table 1, setting out the quantities of bakers' yeast purchased by each customer from NZFI in New Zealand.

Table 1: Baker's Yeast Quantities and Shares

	Liquid & Stabilised Cream Yeast (CYE Tonnes)	All Bakers' Yeast (CYE Tonnes)
Goodman Fielder	[ ]	[ ]
George Weston	[ ]	[ ]
Yarrows	[ ]	[ ]
River Mill	[ ]	[ ]
Other		[ ]
Total	**[ ] 100%**	**[ ] 100%**

166. The report also included Table 2, which set out the impact of NZFI losing key customers. This shows that loss of a major customer would have a substantial impact on NZFI's volumes and profitability.

Table 2: Impact on NZFI of Lost Customers

Customer	**Volume Impact** (CYE Tonnes)	**EBIT Impact**
Goodman Fielder	[ ]	[ ]
George Weston	[ ]	[ ]
Yarrows	[ ]	[ ]
River Mill	[ ]	[ ]
Goodman Fielder, George Weston & Yarrows	[ ]	[ ]
Yarrows, River Mill and Couplands	[ ]	[ ]

167. Charles River Associates considered that as a consequence, Goodman Fielder would have a material degree of countervailing power, and that this would be enhanced by its size in Australia, where it uses [ ] of all fresh bakers' yeast supplied. It stated that since Bakels has significant spare capacity, Goodman Fielder could respond to the threat of price increases in New Zealand by threatening to purchase more of its Australian fresh yeast from Bakels.

168. As discussed above with respect to potential competition, Goodman Fielder advised the Commission that if it were not satisfied with NZFI, it would switch to Bakels. It said that the risk to NZFI of losing Goodman Fielder as a customer as compared with enhancing George Weston's competitiveness would not only be the loss of Goodman Fielder, but also it would provide a platform to Bakels from which it could obtain the rest of the New Zealand fresh yeast business. Burns Philp was also of the opinion that the Applicant would not put its yeast business at risk to assist George Weston.

169. There may be some possibility that NZFI could price discriminate against the smaller bakeries as their business is less critical, and they do not have the countervailing power of the larger bakeries, who are able to leverage through their Australian connections, and cannot credibly threaten to switch to imported yeast on a unilateral basis. However, if NZFI were to raise the price of yeast to smaller bakers, they would lose ground to large bakers with no overall drop in yeast demand; it is simply a 'reallocation' of bread production between bakers.

Conclusion on Countervailing Power

170. The Commission considers that it is unlikely that the combined entity would put Goodman Fielder's business at risk by exercising market power. It also notes the lack of supply contracts between NZFI and its customers and the willingness of customers to switch suppliers. The Commission considers that NZFI's large plant bakery customers, Goodman Fielder in particular, have sufficient countervailing power to prevent NZFI from exercising market power post-acquisition.

Conclusion on Fresh Yeast Market

171. The Commission considers that the proposed acquisition would not result in NZFI having the ability to exercise market power in the fresh yeast market, as the threat of entry by Bakels together with the strong countervailing power of customers, particularly Goodman Fielder, would continue to be a sufficient constraint to prevent NZFI from raising the price of fresh yeast as a result of vertical integration with George Weston.

Leveraging of NZFI's Market Power in the Packaged Bread Market Post-Acquisition

172. Although there are three packaged bread geographic markets - the upper and lower North and South Island markets - the only market share information available is on a national basis. The total market shares for the three packaged bread markets are set out in Table 3.

Table 3: Estimated Market Shares in Packaged Bread Markets

Retailer	Retail Sales (NZ$m)	Wholesale Market Share (%)	Suppliers	Share of Production (%)
Proprietary Key Accounts (i.e. Supermarkets), excl. Housebrands	$[ ]m	[ ]%	Goodman Fielder George Weston Other	[ ]% [ ]% [ ]%
Housebrands	$[ ]m	[ ]%	Goodman Fielder George Weston	[ ]% [ ]%
Proprietary	$[ ]m	[ ]%	Goodman	[ ]%

Retailer	Retail Sales (NZ$m)	Wholesale Market Share (%)	Suppliers	Share of Production (%)
Convenience (i.e. Service Stations)			Fielder George Weston Other	 [ ]% [ ]%
Route (ie 4 Square, Dairies, Fruit/Vege Shops)	$[ ]m	[ ][9]	Goodman Fielder George Weston Other	[ ]% [ ]% [ ]%
Total	**$[ ]m**	**[ ]**	Goodman Fielder George Weston Other	[ ] [ ] [ ]

173. Separate market shares for each of the regional packaged bread markets are not available, but the Commission has been advised that the national market shares are representative of those in the regions. The main difference between the regions is not in the shares, but in which of the independent bakeries supplies each region. Couplands only supplies the South Island [ ], Yarrows only supplies the lower North Island and River Mill only supplies the upper and lower North Island markets.

174. All bakeries spoken to by the Commission were of the view that the packaged bread market is very competitive. The supermarkets also said the market was very competitive and that the independent bakeries were highly competitive and quite aggressive. River Mill and Couplands both advised the Commission that with their budget bread lines they compete head-on with the plant bakeries. The supermarkets use their large buying power to put pressure on bakery suppliers to keep prices down.

175. This competitiveness has been evidenced by pricing activity, with the price of bread having decreased noticeable over the last few years. Foodstuffs Auckland, for example, stated that over the last two to three years the price of bread has come down as a result of suppliers and retailers fighting for market share.

176. The key check on any anti-competitive behaviour arising as a result NZFI's vertical integration with George Weston is the threat of imports as outlined in the previous section. NZFI post-acquisition is unlikely to interfere with the supply of fresh yeast to competitors, such as supplying fresh yeast at relatively disadvantageous terms or at a degraded quality, as it would induce those competitors to source their supply of fresh yeast from elsewhere. The Commission has identified Bakels as this potential

[9] 4 Square represents $[ ] of route sales and [ ] of wholesale market purchases

supplier, [ ] Therefore, George Weston would be unlikely to raise bread prices to consumers. This position is different from that in Decision 487, where the Commission concluded that the threat of imports was low.

177. The Commission also considers that supermarkets have some countervailing power in relation to the bread market. For instance, Goodman Fielder pointed out that it supplies supermarkets with over [ ] of the bread on their shelves, including the Natures Fresh, Freyas, Molenberg, Sunny Crust and Country Split brands. It said that if problems arose with the supply of yeast by NZFI, and Goodman Fielder told the supermarkets that it was not able to supply them with this bread because of NZFI, the supermarkets might take action against George Weston which, like NZFI, would be owned by ABF, and which supplies most of the remainder of the plant bread in supermarkets.

178. The Commission attaches some weight to the argument that if ABF (through NZFI) were to interfere with competitors' supply of yeast this would affect supermarket sales. This consequence could cause supermarkets to take action against George Weston, principally on the basis of refusing to stock its bread.

179. The Applicant also pointed out that in practical terms, NZFI could not provide degraded yeast to some of its customers for reasons that all customers have certain product specifications that NZFI must meet. Since bakeries make bread 363 days a year, a bakery would know very quickly if its yeast were not meeting required performance specifications, and would react accordingly. Nor is it likely that NZFI would interfere with supply by delivering the yeast late. NZFI could expect to face claims of breach of contract in relation to supply of the yeast on standard commercial terms. Also, because yeast production is a batch process, it would be practically very difficult to take out yeast from that batch, deliberately 'degrade' it, and then supply to targeted customer(s).

Conclusion on Packaged Bread Market

180. In Decision 487 the Commission was concerned that competition in the packaged bread market might have been lessened as the merged entity would have been in a position to lever its position in fresh cream yeast into that market. The Commission considers that such leveraging would not occur in the current situation relating to the vertical integration between NZFI and George Weston because:

- the real threat of imports restrains ABF's (through NZFI) behaviour in terms of pricing, quality and continuity of supply of yeast to competitors;
- the countervailing power of the supermarkets; and
- ABF is unlikely to supply competitors fresh yeast of degraded quality or deliver fresh yeast late and risk breach of contract in relation to supply of yeast on standard commercial terms.

181. Therefore, the Commission concludes that the vertical integration resulting from the proposed acquisition would not have and would be unlikely to have the effect of substantial lessening of competition in the packaged bread market.

OVERALL CONCLUSION

182. The Commission has considered the probable nature and extent of competition that would exist in the following markets post-acquisition:

- the national market for the manufacture and wholesale supply of fresh cream and compressed yeast;
- the upper North Island market for the manufacture and wholesale supply of packaged bread;
- the lower North Island market for the manufacture and wholesale supply of packaged bread; and
- the South Island market for the manufacture and wholesale supply of packaged bread.

183. In both the factual and the counterfactual NZFI would continue to operate on its existing site for a maximum of two years and then move to a new site. Some of the existing plant would be moved, but the majority of the plant would be rebuilt.

184. The Commission is of the view that the appropriate counterfactual is that NZFI would be sold to an independent party that would not raise any vertical integration issues, and hence would not create a potential competition concern.

185. The Commission considers that the current cap on NZFI's pricing through threat of imports would continue to constrain the combined entity, given that both George Weston and Goodman Fielder would be available as customers to Bakels. The countervailing power of customers, particularly Goodman Fielder given its large size, also acts as constraint on anti-competitive behaviour by the combined entity that might arise as a result of the vertical integration between NZFI and George Weston, albeit to a lesser extent than the threat of imports.

186. The Commission is satisfied that the possibility of the combined entity interfering with competitors supply of yeast - whether by price or quality – so as to gain a competitive advantage in the bread markets, is unlikely to occur due to: the threat of imports; the countervailing power of supermarkets; ABF being unlikely to reduce margins in the yeast market in the hope that it would be offset by increased margins in the bread market; and ABF is unlikely to supply competitors fresh yeast of degraded quality and risk breach of contract in relation to supply of yeast on standard commercial terms.

187. 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 the following markets:

- the national market for the manufacture and wholesale supply of fresh cream and compressed yeast;
- the upper North Island market for the manufacture and wholesale supply of packaged bread;

- the lower North Island market for the manufacture and wholesale supply of packaged bread; and
- the South Island market for the manufacture and wholesale supply of packaged bread.

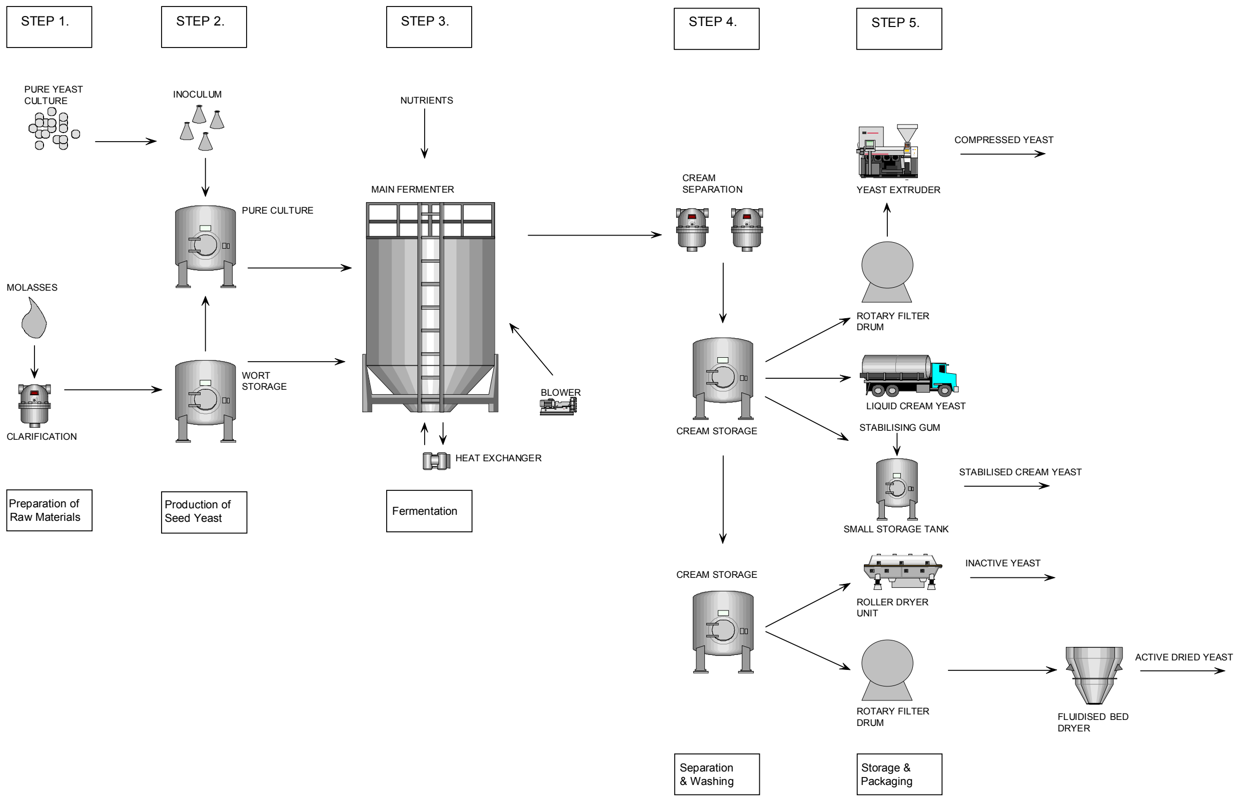
DETERMINATION ON NOTICE OF CLEARANCE

188. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by ABF Overseas Limited of 100% of the shares in New Zealand Food Industries Limited.

Dated this 27th day of August 2004

Paula Rebstock
Chair
Commerce Commission

Appendix 1: Yeast Production Process



- Note that industry practice is to supply and price fresh yeast in terms of the compressed equivalent.

Liquid – 1.85 litres = 1kg compressed
Stabilised – 2 litres = 1kg compressed