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Final Determination

Fonterra Co-operative Group Limited [2012] NZCC 7

The Commission:	Dr Mark Berry Sue Begg Gowan Pickering Dr Stephen Gale
Summary of application:	The Applicant has applied for authorisation of arrangements involving Kotahi Logistics LP. Kotahi is contracted to procure and manage Fonterra's exports by containerised ocean freight. Authorisation is sought to allow Silver Fern Farms Limited, and other exporters and importers, to also contract with Kotahi for ocean freight services.
Determination:	The Commission is not satisfied that the Kotahi arrangements contain an exclusionary provision under s 61(7) of the Act. Having found no exclusionary provision, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(5) and (6) of the Act. The Commission is not satisfied that the Kotahi arrangements will result, or be likely to result, in a lessening of competition under ss 61(6) and (6A) of the Commerce Act 1986. Having found no likely lessening of competition or deemed lessening of competition, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(1) and (2) of the Act.
Date of Determination:	15 March 2012

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

CONTENTS

Acronyms and abbreviations

Applicant	Fonterra Co-operative Group Limited
Bigger Ships Report	New Zealand Shippers' Council, August 2010 report titled "The Question of Bigger Ships: Securing New Zealand's International Supply Chain"
CAU	Contract, arrangement or understanding
Commission	Commerce Commission
Constitution	Constitution of Kotahi GP
Establishment Agreement	Kotahi Logistics LP Establishment Agreement
Exclusivity Requirement	Requirement under clauses 4.1 and 4.4(b) of the LPA and clause 12 of the Services Agreement) that a limited partner "exclusively commit to procure all of its ocean freight services requirements" from Kotahi
Fonterra	Fonterra Co-operative Group Limited
ICL	International container line
ICLC	International container lines committee
Intermodal freight services	Transport of product to/from New Zealand ports by road, rail and coastal shipping
Kotahi	Kotahi Logistics LP
Kotahi arrangements	Matters in terms of Kotahi for which authorisation is sought
Kotahi GP	Kotahi GP Limited
Limited Partners	Fonterra, SFF and other importers and exporters, that become limited partners of Kotahi
LPA	Limited Partnership Agreement between Kotahi GP, Fonterra, SFF and Kotahi
para	Paragraph
Pricing Mechanism	The pricing mechanism set out in clause 4.8 of the LPA
Reefer	Refrigerated container
s	Section

Services Agreement	The draft services agreement between Kotahi and Silver Fern Farms, which specifies what services Kotahi would provide.
SFF	Silver Fern Farms Limited
Shipping Act	Shipping Act 1987
SLC	Substantial lessening of competition
subs	Subsection
TEU	Twenty-foot equivalent unit – a 20 foot by 8 foot by 8 foot container
the Act	Commerce Act 1986
VSA	Vessel sharing arrangement

Executive summary

X1. This is an executive summary of the determination by the Commerce Commission (the Commission) in respect of an application from Fonterra for authorisation of possibly restrictive trade practices under s 58 of the Commerce Act 1986 (the Act).

Determination

X2. Fonterra Co-operative Group Limited (Fonterra or the Applicant) sought authorisation of arrangements involving Kotahi Logistics LP (Kotahi), an entity established to procure and manage services for containerised ocean freight on behalf of exporters and importers. Fonterra was concerned that the Kotahi arrangements might be considered to contravene some of the restrictive trade practice provisions of the Act, hence its application for authorisation.

X3. The Commission's decision is to decline Fonterra's application for authorisation on the basis that the Commission does not have jurisdiction. In this context, jurisdiction is the legal term that refers to the Commission's authority to grant an authorisation.

X4. The Commission is not satisfied that the Kotahi arrangements are likely to breach the restrictive trade practice provisions of the Act, such that authorisation is available. Specifically:

X4.1 The Commission is not satisfied that the Kotahi arrangements contain an exclusionary provision to which s 29 of the Act would or might apply.

X4.2 The Commission is not satisfied that s 30 of the Act would or might apply to the Kotahi arrangements, such that there is a deemed lessening of competition.

X4.3 The Commission is not satisfied that the Kotahi arrangements will result, or be likely to result, in a lessening of competition. There is unlikely to be a material difference in competition, with or without Kotahi. Therefore, Kotahi is unlikely to breach s 27 of the Act.

X5. The Commission's decision does not prevent Fonterra from proceeding with the Kotahi arrangements. Even though no authorisation has been granted, the Commission's determination may provide parties to the Kotahi arrangements with a degree of comfort if they proceed with the arrangements. This is on the basis that it is unlikely that the Commission would take court action in the future unless the facts on which the application is based materially change. Further, in the event that any third party attempted to challenge the arrangements in question, the limited partners of Kotahi would have the benefit of the Commission's findings in this determination.

Relevant markets

X6. For the purposes of considering Fonterra's application for authorisation of the Kotahi arrangements, the Commission has defined the following relevant markets:

X6.1 Supply of management services for containerised ocean freight.

X6.2 Procurement of containerised ocean freight.

X6.3 Procurement of port services for containerised ocean freight.

X6.4 Procurement of intermodal services for containerised ocean freight.

Shipping exemptions do not apply

X7. Section 44(2) of the Act and s 14 of the Shipping Act 1987 (the Shipping Act) provide certain shipping-related exemptions from the restrictive trade practice provisions of the Act. The Commission has considered whether these apply to the Kotahi arrangements, such that there is nothing (or at least less) to authorise. The Commission's view is that neither of the shipping exemptions applies to the Kotahi arrangements, because Kotahi would procure services for containerised ocean freight but not physically carry goods.

Lack of exclusionary provision

X8. Limited partners of Kotahi are required to exclusively commit to procure all ocean freight services requirements from Kotahi. Fonterra sought authorisation for the possibility that this Exclusivity Requirement may breach s 29 of the Act.

X9. The Commission's view is that the Kotahi arrangements are unlikely to contain an exclusionary provision that breaches s 29. The purpose of the Exclusivity Requirement is not to restrict the supply or acquisition of services from any particular person(s).

Section 30 does not apply

X10. Kotahi is to negotiate pricing of services for containerised ocean freight on behalf of its limited partners and customers. The Kotahi arrangements also include a Pricing Mechanism that would influence the prices charged by Kotahi to individual exporters and importers for the supply of management services for containerised ocean freight. Fonterra sought authorisation for the possibility that the Kotahi arrangements might breach s 27 via s 30 of the Act.

X11. The Kotahi arrangements are unlikely to contain price fixing provisions in relation to the procurement of containerised ocean freight that would breach s 27 via s 30 of the Act. The Commission has not been directed to any provisions of the Kotahi arrangements that influence the prices at which Kotahi would purchase the relevant services. In the absence of such provisions, the prices to be negotiated would be those between a single corporate entity, Kotahi, and relevant international container lines (ICLs) in much the same way as a freight forwarder might negotiate with ICLs

for its clients. To that extent, there is no arrangement among separate competitors to fix, control or maintain prices for the procurement of containerised ocean freight.

X12. As to the supply of management services for containerised ocean freight, the Commission's view is that s 30 does not apply to Kotahi's Pricing Mechanism for two separate reasons:

X12.1 None of the parties to the Kotahi arrangements are in competition with each other for the supply of management services for ocean freight.

X12.2 Section 31 would in any event exempt the Pricing Mechanism from the application of s 30. Section 31 provides an exemption from s 30 for joint ventures like Kotahi.

No lessening of competition likely to result from Kotahi

X13. Fonterra sought authorisation for the possibility that the Kotahi arrangements may, at some point in the future, breach s 27 of the Act. A breach may occur if the Kotahi arrangements lead to a substantial lessening of competition (SLC) in one of the relevant markets. Fonterra submitted that whether this would occur depends on the number of other exporters and importers that become limited partners or customers of Kotahi.

X14. The Commission only considers granting authorisation in respect of s 27 for arrangements that are likely to result in a lessening of competition. The need to show some lessening arises from the statutory requirement that there be some competitive detriment to balance against benefits to the public. In the current case, the Commission is not satisfied that the Kotahi arrangements will result, or be likely to result, in a lessening of competition.

X15. It is uncertain at this time how many other exporters and importers, beyond Fonterra and Silver Fern Farms Limited (SFF), may choose to become limited partners or customers of Kotahi. At this time, the Commission has identified five other exporters who are considering what Kotahi has to offer and are likely to become limited partners or customers of Kotahi within the next two years. The Commission has found no interested importers.

X16. There is unlikely to be a material difference in competition, with the Kotahi arrangements or without them. Fonterra submitted that without Kotahi, the arrival of bigger ships to New Zealand would be delayed, or not occur at all, with services hubbing via Australia instead. However, the Commission has not found evidence to support these submissions. The Commission's view is that the situation without the Kotahi arrangements will be the status quo (with natural market developments).

X17. There would only be a small increase in Kotahi's market share with the arrangements, which would be unlikely to provide Kotahi with monopsony power. Even if Kotahi did obtain monopsony power, it is unlikely to be incentivised to use that power. Kotahi would likely have increased countervailing power. But, countervailing power is different to monopsony power. Further:

X17.1 In exercising countervailing power, buyers can threaten to switch to another supplier and thereby achieve lower prices. Countervailing power can be efficiency enhancing if prices are pushed down closer to 'competitive levels' and lead to an increase in total welfare.

X17.2 Monopsony power is where a single buyer represents all or a significant portion of the market. It is similar to monopoly power, where one supplier represents a significant portion of the market. In either market situation, the single buyer or supplier likely has considerable control over the market. The exercise of monopsony power involves the exercise of market power by a buyer to depress prices below competitive levels and leads to a reduction in total welfare.

Introduction

1. This document is the Commission's determination in respect of an application from Fonterra under s 58 of the Act seeking authorisation of possible restrictive trade practices.

2. Fonterra has sought authorisation of arrangements involving Kotahi. Kotahi is already contracted to procure and manage Fonterra's exports by containerised ocean freight. Authorisation is being sought to allow SFF, plus other as yet undetermined exporters and importers, to also contract with Kotahi for freight services.

Determination

3. The Commission's decision is to decline Fonterra's application for authorisation on the basis that the Commission does not have jurisdiction. In this context, jurisdiction is the legal term that refers to the Commission's authority to grant an authorisation.

4. The Commission's view is that the Kotahi arrangements are unlikely to contain any exclusionary provisions to which s 29 of the Act may apply. This is because:

    4.1 In terms of s 29(1)(b), the Commission is not satisfied that Kotahi involves an exclusionary purpose.

    4.2 In addition, there is uncertainty as to whether there is due particularity regarding the intended target of the exclusionary provision. To be an exclusionary provision, the provision in the arrangement cannot be aimed generally.

5. Having found no exclusionary provision, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(5) and (6) of the Act.

6. The Commission considers that the Kotahi arrangements would not likely result in a lessening of competition in any of the relevant markets. This is because:

    6.1 The Commission is not satisfied that the Kotahi arrangements contain price fixing provisions under s 30, such that there is a deemed lessening of competition.[1] In addition Kotahi is likely to be a joint venture for the purposes of s 31, such that the Pricing Mechanism would be exempt from the application of s 30 in any event.

    6.2 There is unlikely to be a material difference in competition with or without Kotahi. Under s 27, the Commission is not satisfied that Kotahi would or might lessen competition.

[1] While no specific reference to s 30 appears within ss 58 or 61, the s 30 price fixing provision deems a substantial lessening of competition and therefore a breach of s 27. That is, if a price fixing provision is established for the purposes of s 30 there will necessarily be a contravention of the prohibition contained in s 27(1).

7. Having found no likely lessening of competition or deemed lessening of competition, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(1) and (2) of the Act.

Submission on the Draft Determination

8. The Commission received only one submission on its Draft Determination on this matter. That submission was received from Fonterra, the Applicant. Fonterra agreed with the Commission's preliminary decision to decline to grant authorisation but made submissions on a number of points in the Draft Determination. Fonterra submitted that:[2]

   8.1 There is no difference between *procurement* and *provision* of various freight services.

   8.2 Kotahi is not a procurer of port services.

   8.3 The counterfactual, in terms of port investment, will not be the status quo.

9. In reaching its final determination, the Commission has had regard to Fonterra's submission on these points. However, as acknowledged by Fonterra, nothing in Fonterra's submission challenges the overall conclusions reached by the Commission in its Draft Determination. Accordingly, the Commission's decision is to decline to grant authorisation on the basis that it does not have jurisdiction.

10. This final determination includes no discussion of Fonterra's submission on benefits. Having found no lessening of competition or exclusionary provision, the Commission has seen no need to analyse benefits and detriments in this final determination. Such analysis was included in the Draft Determination to aid the consultation process, in the event that the Commission later changed its position on the lessening of competition.

Background

Parties to the agreements

11. Currently, Fonterra is registered as the sole limited partner of Kotahi. Through a number of agreements, SFF proposes to also become a limited partner.

Fonterra

12. Fonterra is a vertically integrated dairy products manufacturer and marketer, operating in dairy product markets in New Zealand and numerous other countries. It currently collects approximately 89% of raw milk in New Zealand.

13. Fonterra is New Zealand's largest exporter by volume, exporting [ ] TEUs per annum. It exports an estimated [ ]% of its New Zealand production. Fonterra submitted that its export volumes represent approximately [ ]% of New Zealand's

[2] Submission on the Draft Determination from Grant David (Chapman Tripp, on behalf of the Applicant) to the Commerce Commission (15 February 2012).

annual containerised exports. As New Zealand's largest exporter, Fonterra is a major user of containerised ocean freight from New Zealand as well as road and rail transport services within New Zealand.

SFF

14. SFF is a vertically integrated procurer, processor and marketer of sheep, lamb, beef and venison meat. It operates in markets supplying meat products in New Zealand and several other countries. SFF currently acquires and processes [ ]% of red meat in New Zealand.

15. SFF is a large scale exporter of New Zealand produce, exporting [ ] TEUs per annum. Approximately [ ]% of its produce is exported. The Applicant submitted that SFF represents [ ]% of New Zealand's annual containerised exports.

Kotahi

16. Kotahi has been established by Fonterra to coordinate demand for ocean freight services. Kotahi is already contracted to procure and manage Fonterra's exports by containerised ocean freight. However, authorisation is being sought to allow SFF, plus other exporters and importers, to also contract with Kotahi for freight services.

17. The Applicant has provided the following synopsis of Kotahi:[3]

> The Kotahi proposal envisages Fonterra combining with other New Zealand producers (led by Silver Fern Farms) and importers to promote greater efficiency of the supply chain through pooling and coordinating demand for container freight services on sea and increasingly on land. That coordinated and aggregated demand will ensure and bring forward port investment to enable use of bigger ships for the carriage of goods by sea from and to New Zealand. It will also promote development of an efficient domestic freight system that more effectively combines intermodal transport of export and import cargoes with bigger ships capable ports.

18. Kotahi is to procure and manage the provision of containerised ocean freight on behalf of contracted exporters and importers. Kotahi will not provide services in respect of bulk or non-containerised cargo. It is not proposed that Kotahi will be involved in the freight of products made or produced in New Zealand and destined for domestic markets. Kotahi will procure and manage the following services:

    18.1 The transport of product between New Zealand and overseas ports by containerised ocean freight.

    18.2 The transport of product to/from New Zealand ports by road, rail and coastal shipping (intermodal freight services).

19. In the procurement of containerised ocean freight, Kotahi will contract with the various ICLs offering services to/from New Zealand ports. Kotahi will make and manage bookings with these ICLs on behalf of its contracted exporters and importers. The ICLs directly contract with port companies and other providers for

[3] Fonterra application for authorisation (12 September 2011), at para 2.1.

services associated with the loading and unloading of containers from their ships, the storage of containers at ports and other port related services.

20. In procuring intermodal freight services, Kotahi plans to contract with road transport companies, KiwiRail and coastal shipping companies. However, Kotahi will initially outsource this transport function to a Fonterra subsidiary, Dairy Transport Logistics Limited, using its existing contractual arrangements.

21. Kotahi proposes to pool and coordinate the container freight volumes of its contracted exporters and importers through fewer ports. In doing so, it aims to leverage scale to deliver better service and achieve cost savings.

22. To achieve its desired objectives, Kotahi needs a degree of scale. Fonterra and SFF together export around [ ] TEUs per annum. Kotahi wishes to secure (as additional limited partners or customers) "complementary business from other container freight users to reach a critical mass of cargo".[4] Kotahi has advised the Commission that it aims to manage [ ] to [ ] TEUs of New Zealand's containerised exports, plus some level of imports.[5]

Industry characteristics

Profile of exports and imports

23. New Zealand is a net exporter, by tonnage, both overall and in terms of containerised goods. For the year to 30 June 2011, New Zealand's total exports were 31 million tonnes compared to total imports of 18 million tonnes.

24. Primary products are a significant portion of New Zealand's exports, by both value and volume. The Applicant submitted that primary products comprise two-thirds of New Zealand's exports by value. This causes seasonal fluctuations in export volumes across the year when perishable products need to get to market. Key primary export sectors include dairy, meat, forestry, seafood and horticulture. There are at least 25 individual exporters with volumes of over 3,000 TEUs per annum.

25. New Zealand's imports are more fragmented, with a few large importers and a long tail of small players. Neither Fonterra nor SFF is a significant importer. In terms of containerised ocean freight, significant importers include The Warehouse and the two supermarket chains.

Container imbalance

26. New Zealand has a container imbalance in that more containers leave New Zealand full of exports than are needed for imports. In addition, the significance of primary products in terms of exports means that a sizeable portion of exports are shipped in

4 Application, at para 2.5.
5 Commerce Commission interview with Kotahi (30 September 2011).

refrigerated containers (reefers), as opposed to dry containers.[6] In contrast, imports are predominantly shipped in dry containers.

27. In addition, there is a geographical imbalance in export and import flows. Imports mainly arrive into Auckland or Tauranga, while exports are shipped from up to 11 container ports around the country.

Volumes of containerised ocean freight

28. The Commission has experienced some difficulties in getting accurate information on New Zealand's volumes of containerised ocean freight. For the purposes of this determination the Commission estimates that between 650,000 and 840,000 TEUs are currently exported from New Zealand per year. Further discussion on volumes of ocean freight can be found in Attachment A.

Vessel sharing arrangements

29. A number of ICLs operate services for containerised ocean freight to/from New Zealand. In order to have ships as full as possible, many of the ICLs operate services by way of vessel sharing arrangements (VSAs). VSAs are agreements between two or more ICLs to share space on a ship.

30. VSAs are likely to benefit exporters and importers, assuming that they result in sufficient ocean freight capacity and service frequency, whilst maintaining competition between ICLs (in terms of both volumes and prices). Continuing use of VSAs is likely to be needed if ICLs are to bring bigger ships to New Zealand.

Matters for which authorisation is sought

31. Fonterra has stated that the following arrangements may require authorisation under s 58 of the Act:[7]

    31.1 Exclusivity Requirement.

    31.2 Kotahi's charges to limited partners and customers (Pricing Mechanism).

    31.3 Kotahi's negotiation of ocean freight rates with ICLs.

    31.4 Extension of limited partnership to intermodal services for containerised ocean freight.

32. Elsewhere in this document the Commission refers to these arrangements together as the Kotahi arrangements. These arrangements are discussed briefly below and further details of the Kotahi arrangements and Kotahi's legal structure can be found in Attachment B.

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6 The Productivity Commission estimates that 28% of full containers exported are reefers. New Zealand Productivity Commission "International Freight Transport Services Issues Paper" July 2011.

7 Application, at paras 2.11 and 5.18.

Exclusivity Requirement

33. Clauses 4.1 and 4.4(b) of the Limited Partnership Agreement (LPA) between Kotahi GP Limited (Kotahi GP), Kotahi and SFF record that each partner of Kotahi would enter into a Services Agreement under which the partner would commit to exclusively procure all of its ocean freight services requirements from Kotahi (Exclusivity Requirement). Clause 12 of the Services Agreement[8] between Kotahi and SFF sets out the Exclusivity Requirement.

34. The Applicant submitted that the Exclusivity Requirement may be in breach of s 29. This is on the basis that the provision has the purpose of preventing the acquisition of ocean freight services from a class of persons (i.e. directly from ICLs or from ICLs that Kotahi does not purchase from) and these persons indirectly compete with Kotahi in that they could (as they currently do) supply their services to the limited partners directly.[9]

35. The Applicant also submitted that s 27 of the Act might apply to these clauses because, depending on the freight volumes of its limited partners and customers, Kotahi is able to aggregate on an exclusive supply basis. Therefore the Applicant considers that there may be sufficient foreclosure of ICLs in the relevant market(s) if those ICLs are unable to access sufficient volumes of independent customers, and this may have the effect of an SLC. [10]

Kotahi's charges to limited partners and customers (Pricing Mechanism)

36. Under clause 4.8 of the same LPA, the limited partners agree that the ocean freight charges to be paid by themselves and the customers of Kotahi (that is, Kotahi's charges for procurement and management services) would reflect [ ] (Pricing Mechanism[11]). [ ] The Applicant submitted that s 30 might apply to clause 4.8 of the LPA. The Pricing Mechanism is also reflected in clause 17 and schedule 2 of the proposed Services Agreement.[12]

Kotahi's negotiation of ocean freight rates

37. Under clause 3 of the Kotahi Logistics LP Establishment Agreement (Establishment Agreement) between Fonterra, SFF, Kotahi GP and Kotahi, Kotahi would negotiate ocean freight rates on behalf of its limited partners and customers who, absent the

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8 The Services Agreement was supplied to the Commission as part of Fonterra's authorisation application. It is the draft Services Agreement between Kotahi and Silver Fern Farms, which specifies what services Kotahi would provide.

9 Application, at para 5.18.

10 Ibid.

11 Clause 4.8 of the LPA: "...pricing to limited partners and customers of the limited partnership will reflect [ ] and it is intended that [ ] will be retained in the pricing received by the limited partners and customers under their respective services agreements with Kotahi Logistics."

12 Letter from Grant David (Chapman Tripp, on behalf of the Applicant) to Commerce Commission responding to request for clarification in respect of intermodal freight services (25 November 2011), at para 5.1.

provision, are competitors for the acquisition of services for containerised ocean freight. The Applicant submitted that s 30 might apply to clause 3 of the Establishment Agreement, clauses 2.7, 5 and schedule 2 of the LPA and clauses 43 and 44 of Kotahi GP's Constitution.[13]

Extension of limited partnership to procurement of intermodal services for containerised ocean freight

38. The Applicant submitted that Kotahi's initial focus would be on optimising export/import services for containerised ocean freight for its limited partners and customers. Over time, Kotahi intends to develop and offer intermodal freight services for containerised ocean freight comprising road, rail and coastal shipping. This would occur as opportunities to generate cost savings or provide a better service offering are identified.[14]

39. The Applicant seeks authorisation for the provisions of the LPA and Constitution that combined, in the applicant's view, are likely to breach s 27 via s 30. The Applicant submitted that clauses 2.7, 5 and schedule 2 of the LPA and clauses 43 and 44 of the Constitution are likely to have the effect of the parties fixing, controlling or maintaining the price of intermodal freight services.[15]

40. The Commission acknowledges the difficulty for Kotahi in predicting the level of uptake of its proposal by parties (other than Fonterra and SFF) and the difficulty in identifying when Kotahi would be in a position to offer intermodal freight services to its limited partners and customers.[16]

41. In the Commission's view it is able to consider authorisation only in terms of proposed actual arrangements between parties. This is consistent with the Commission's view in past authorisation decisions. In *New Zealand Grape Growers Council Incorporated,*[17] the Commission was of the view that without knowing the terms of such contracts, it was unable to consider granting an authorisation for the requested arrangement. The Commission went on to say that it did not propose to consider extending any authorisation to cover practices in contracts, details of which were unknown to it.[18]

42. The Applicant submitted that while the provisions of the draft Services Agreement do not currently deal with the provision of intermodal services by Kotahi, there are some aspects of the proposed arrangements relating to the potential provision of

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13 Ibid.

14 Ibid, at para 2.

15 Ibid, at para 5.2.

16 Consequently, there is also uncertainty as to what the intermodal freight services provisions in any proposed Services Agreement would look like and the identity of any potential parties who may use such intermodal freight services.

17 *The New Zealand Grape Growers Council Incorporated* (Commerce Commission Decision 263, 1991), at para 23.3.

18 Ibid, at para 24.3. In the Commission's view, this is also evident from ss 58A and 58B of the Act which sets out the effect of an authorisation and the circumstances under which authorisations may cover parties not yet part of the proposed arrangement.

intermodal freight services that currently require authorisation.[19] The Commission, therefore, has proceeded to consider and assess the application on the basis of the information provided to date.

Key issues raised by the authorisation

43. Fonterra's application for authorisation raises a number of key issues for the Commission to consider, specifically:

    43.1 Whether all or part of the Kotahi arrangements are exempt from the application of Part 2 of the Act by s 14 of the Shipping Act or s 44(2) of the Act.

    43.2 Whether the Kotahi arrangements contain exclusionary provisions that are likely to breach s 29 of the Act. Such arrangements may be authorised under s 61(7) if they are of net benefit to the public.

    43.3 Whether the Kotahi arrangements contain price fixing provisions that are likely to breach s 27 via s 30 of the Act. Such arrangements may be authorised under s 61(6) if they are of net benefit to the public.

    43.4 Whether the Kotahi arrangements are likely to lead to a lessening of competition that may breach s 27 of the Act. Such arrangements may be authorised under s 61(6) if they are of net benefit to the public.

44. In the Commission's view, the power conferred on the Commission to grant an authorisation could not have been intended to be used in circumstances where there is no real risk of a restrictive trade practice provision applying to the proposed conduct.

45. Under s 58 of the Act a person may apply for and the Commission may grant an authorisation where the applicant considers that one or more of the restrictive trade practice provisions of the Act (with the exception of ss 36 and 36A) would or might apply to the proposed conduct. Therefore a person's decision to apply for an authorisation under s 58 is governed by his or her own view as to the potential application of the restrictive trade practices provisions to their proposed conduct.

46. However, the Commission considers that the discretion conferred on it by s 61 of the Act to grant an authorisation or decline an application – even where the public benefits tests in ss 61(6) to (8) are met – requires the Commission to form its own view about whether the relevant provisions of the Act might apply to the proposed conduct.[20] The Commission considers that doing so is necessary for the proper operation of its mandate in authorisation matters.[21]

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[19] Letter from Grant David, above n 12, at para 19. For example, schedule 2 of the LPA contemplates that the business of Kotahi would include the provision of intermodal (land and ocean) based transport solutions for importers, exporters and carriers.

[20] This view of the Commission's discretion is consistent with the view expressed by the Australian Competition Tribunal, albeit in the context of the ACCC's discretion under the Australian authorisation

47. This conclusion is supported by the references in s 61 to the underlying restrictive trade practices at issue. For the purposes of the present application, the relevant references are to "the lessening in competition" mentioned in s 61(6), and to "the exclusionary provision" in s 61(7). Reference to these factors in s 61 presupposes their existence in fact, and suggests a need for the Commission to decide whether the relevant restrictive trade practice provisions (being in this case ss 27, 29 and 30 of the Act) apply before it can conduct its benefits and detriments analysis and consider whether to grant authorisation. The Commission therefore considers that it is incumbent on it to make its own determination as to whether the relevant restrictive trade practice provisions apply to the proposed arrangements.

48. The Commission therefore only proceeds to the benefits and detriments analysis where it is satisfied that one or more of the relevant restrictive trade practice provisions of the Act might apply to the proposed conduct. Where this criterion is not met (as in this case), the Commission declines the application without weighing the benefits and detriments, on the basis that no competition issue arises.

49. The Commission considers the shipping exemptions and ss 27, 29 and 30 in the relevant sections below. Sections 29 and 30 are considered before s 27, as they are *per se* violations of the Act, whereas s 27 requires analysis to ascertain if a lessening of competition is likely to occur.

50. The Applicant is applying for authorisation of arrangements to which ss 27, 29 and 30 may apply at some future date depending on uncertain factors, like take up of Kotahi services by exporters. The Applicant notes that "...it is impossible to identify in advance the precise point at which the prohibited "substantial lessening" threshold may be crossed."[22] It further submitted that s 61(6A) of the Act allows the Commission to authorise anticipatory breaches of s 27 by providing that *any* lessening of competition gives the Commission the jurisdiction to grant authorisation. The Commission disagrees with the Applicant's interpretation of s 61(6A). In the Commission's view, the result of the amendment to the Act in 1996 to include subsection (6A) was to reduce the level of lessening of competition required to establish jurisdiction. The subsection does not provide guidance on whether the Commission can authorise anticipatory breaches.

51. The Commission considered whether or not any lessening of competition is likely to result from the Kotahi arrangements. The analysis is forward looking, but extends only as far out into the future as the Commission is able to assess likelihood. In this

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regime in the Trade Practices Act 1974. See *Re Application by Medicines Australia Incorporated* [2007] Australian Competition Tribunal 4 (27 June 2007) at paras 122 and 128. To similar effect is *Jones v Australian Competition and Consumer Commission* (2002) FCA 1054 at para 50, where the Federal Court of Australia held that "[a]s a matter of basic principle, the power conferred on the ACCC to grant an authorisation could not have been intended to be used in circumstances where that body concluded that there was clearly no risk of any contravention..."

[21] As noted in *Re Application by Medicines Australia Incorporated* [2007] Australian Competition Tribunal 4 (27 June 2007) at para 128, "Authorisation is a public and official act of some seriousness. It is not to be invoked for trivial cause. To grant authorisation in such cases may risk like applications with wastage of resources as well as the risk that the authority of the ACCC itself may be diminished."

[22] Application, at para 5.19.

determination, analysis has been conducted using a timeframe of approximately 1-2 years. This is because New Zealand exporters and importers tend to have 1 or 2 year contracts with ICLs for containerised ocean freight. Information obtained through interviews suggests that, as contracts expire in the next 1-2 years, some exporters and importers may consider joining Kotahi. But, it is difficult to assess what is likely to happen beyond a two year timeframe.[23]

52. In relation to benefits, future benefits that are likely to result, are able to be considered by the Commission. A "likely" effect must be "probable" and not just possible or speculative.[24] As the Commission noted in *Weddel Crown Corp Ltd*, "this does not mean that the likely effects must be more probable than not, but rather that there must be a tendency or real probability of a particular result."[25] The further into the future the "likely" benefits or effects of a practice, the less weighting will be given to them.[26]

53. Before considering these issues further, the Commission has first defined the relevant markets in which Kotahi operates, and has identified the relevant factual and counterfactual for the analysis.

Market definition

54. The Commission considers that the relevant markets are those that Kotahi supplies into and those markets in which Kotahi is a procurer of services. These markets are for the:

    54.1 *Supply of management services for containerised ocean freight*: this market is relevant for analysis of s 14 of the Shipping Act, s 44(2) of the Act, and ss 29 and 30.

    54.2 *Procurement of containerised ocean freight*: this is relevant for the s 27 and s 30 analysis.

    54.3 *Procurement of port services for containerised ocean freight*: this is relevant for the s 27 analysis.

    54.4 *Procurement of intermodal services for containerised ocean freight*: this is relevant for the s 30 analysis.[27]

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[23] When considering potential entry, the Commission applies the LET test ie whether entry is Likely, sufficient in Extent and Timely. The timeframe for such analysis varies depending on the facts of the case. For example, in *Commerce Commission v New Zealand Bus Ltd* (2006) 11 TCLR 679 conditions of entry were analysed within a three year timeframe, rather than the two years that the Commission normally adopts as a first approximation.

[24] *Air New Zealand Ltd v Commerce Commission* [1985] 2 NZLR 338, 341-342.

[25] *Weddel Crown Corp Ltd* (1987) 1 NZBLC (Com) 104,200 quoting at 104, 213 from Re *Howard Smith Industries Pty Ltd* (1977) 1 ATPR 17, 324.

[26] *Carter Holt Harvey Ltd/Elders Resources NZFP Ltd* (1990) 2 NZBLC (Com) 104,549, 104,555-6.

[27] As noted in para 175, Fonterra has not requested authorisation for intermodal freight services in respect of a potential breach of s 27.

55. The Applicant submitted that the relevant markets affected by the Kotahi proposal are, initially, the provision and procurement of container freight services by sea to and from New Zealand and related landside services.[28] As Kotahi operates on the procurement side of that market, the Commission has not considered in detail the provision of container freight services. The Applicant also submitted that a relevant market is the procurement of intermodal transport services to and from ports.[29]

56. The relevant markets are considered in more detail below.

Market for the supply of management services for containerised ocean freight

57. The Commission considers that a relevant market in this instance is for the supply of management services for containerised ocean freight in New Zealand.

58. The Act defines a market as:

> a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.[30]

59. For 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 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 considered to be the relevant market.

60. Kotahi will contract with its limited partners and customers to provide a package of services including freight procurement, freight management and other related services, as specified in the Services Agreement. Kotahi will outsource the provision of many services – such as the actual carriage of goods which will be outsourced to ICLs, road transport companies, KiwiRail and coastal shipping companies (and potentially other parties). One service that Kotahi will actually supply is that of management services for containerised ocean freight.

61. Kotahi competes against ICLs, along with other entities like freight forwarders, in supplying management services for containerised ocean freight. Should a sole supplier of management services for containerised ocean freight seek to increase prices, then exporters could simply contract directly with ICLs. In fact, in the majority of cases exporters currently do contract directly with ICLs.

62. ICLs do not provide the range of management services for containerised ocean freight that Kotahi intends to provide. However, some of the exporters spoken to by the Commission are weighing up the pros and cons of contracting with Kotahi to manage their freight services, rather than contracting directly with the ICLs,

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28 Application, at paras 19.7 to 19.8.
29 Ibid, at para 19.9.
30 Section 3(1A) of the Act.

indicating that the two services offered are likely price-constraining substitutes for each other and so are likely in the same market.

63. While Kotahi and ICLs compete to supply management services for containerised ocean freight, Kotahi does not compete with ICLs directly in the physical carriage of goods. That is, there is an additional market for the physical carriage of goods, in which Kotahi does not compete.[31]

Markets for the procurement of containerised ocean freight

64. The Commission considers that relevant markets in this instance include:

    64.1 Containerised ocean export freight, which can be defined as the carriage of New Zealand export cargo to international destinations.

    64.2 Containerised ocean import freight, which can be defined as the carriage of international cargo destined for New Zealand.

65. These markets are defined as procurement markets as Kotahi is a buyer, rather than a supplier, in these markets. In analysing procurement markets, the Commission is concerned with a buyer driving down prices, rather than a supplier raising prices. As noted above, a market is generally considered to be the smallest space in which a hypothetical, sole supplier could profitably impose an increase in price. However, as the proposed authorisation is designed to give effect to a buyer group and the potential concern is that of monopsony power, the question in this instance is whether a sole purchaser of a good or service would be able to impose a small yet significant non-transitory decrease in price. That is, in the face of a potential decrease in price, can the suppliers of a product or service profitably switch to alternative buyers or modify their product or service in sufficient quantity so as to render the input price decrease unprofitable to the buyer.

66. The Commission's view is that containerised ocean export and import freight are in separate markets. ICLs endeavour to balance their import and export flows of freight to utilise capacity on both legs of their voyage. From the ICLs perspective, demand for export freight is a complement of, rather than a substitute for, demand for import freight. That is, if the price of containerised export freight decreased, ICLs would be unable to switch to providing containerised import freight instead.

67. For ICLs, there is no feasible alternative to their ships for carrying containerised ocean freight, beyond the possibility of converting them (an expensive process) to be able to carry other types of goods.

68. In the face of a price decrease, ICLs may be able to redeploy their ships to other destinations. By their very nature, container ships are portable. If ICLs could earn at least as much of a return from other countries or routes in the world as they earn on New Zealand routes, the market could be wider than just containerised exports

[31] This is analogous to travel agents who compete directly with airlines for the sale of airline tickets, but who do not constrain airlines in terms of the provisions of the flight services themselves.

from, and imports to, New Zealand.[32] Even if this is the case, New Zealand is the only segment of the market relevant to the authorisation application.

69. There is a question as to whether there are separate markets for reefers and dry containers. The Commission understands that while reefers cost more for ICLs to purchase and operate, the margin for their carriage is significantly higher. It is unclear whether ICLs could profitably switch to only carrying dry containers if the price of reefers decreased. The Commission has drawn no firm conclusion on this as it is unlikely to have a significant impact on the competition analysis.

70. The Applicant submitted that there are likely to be several geographic markets for containerised ocean freight corresponding to various trade routes from New Zealand.[33] However, ICLs have the ability to switch ships to service different destinations. For instance, if a monopsonist tried to force down prices on routes to the Americas, ICLs may be able to switch their services to other destinations such as Asia. Nevertheless, for this determination, the Commission does not consider it necessary to reach a definitive view on this point as it is unlikely to alter the competition analysis.

Market for the procurement of port services for containerised ocean freight

71. Another relevant market is the procurement of port services for containerised ocean freight in New Zealand. Again, Kotahi is a buyer, rather than a supplier, in this market.

72. Fonterra has sought authorisation for, amongst other things, procurement services for containerised ocean freight. Port services are used in all containerised exports from, and imports to New Zealand, and are therefore a component of services for containerised ocean freight. By Kotahi's limited partners committing to exclusively procure ocean freight services from Kotahi, in the Commission's view, they are also committing to exclusively procure port services via Kotahi, albeit indirectly. The Commission does not agree with the Applicant's submission[34] that Kotahi is not a procurer of port services, for the reasons outlined below.

73. At present, exporters contract with ICLs to provide services for containerised ocean freight. ICLs then contract with the ports for the port services that ICLs need to provide services for containerised ocean freight.

74. However, exporters do have direct relationships and contracts with ports, whereby ports provide incentives for exporters to use their particular port facility. Examples of these include direct rebates of port charges to exporters based on their volumes, the

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32 Section 3(1A) of the Act provides that the term "market" is a reference to a market in New Zealand. However, as noted in *Commerce Commission v Air New Zealand Limited*(2011) 9 NZBLC 103, 318 – at para 235, the words "in a market" are not on their plain meaning and in the context of the other provisions of the Act limited to markets *wholly* in New Zealand. It is sufficient for the purposes of market definition analysis under the Act that the market is partly in New Zealand and therefore constraints from outside the domestic market can be considered.

33 Application, at para 21.5.

34 Applicant's submission on the Draft Determination, above n 2, at paras 29-36.

provision of intermodal freight services, and contracts for storage, packaging or exports.

75. In this manner, ports have the ability to discriminate between exporters by implicitly lowering the total cost to exporters of containerised ocean freight services. The Applicant submitted that there is no implicit lowering of port charges through such arrangements. However, in the Commission's view, there is at least a theoretical possibility that Kotahi may, if it achieves sufficient scale, have monopsony power in a market for the procurement of port services.

76. The Commission considers the relevant product in this instance is the procurement of containerised export port services. In the face of a price decrease, ports may be able to switch to providing services to other types of shipping companies, such as bulk cargo, charter ships, and cruise liners. However, given most New Zealand ports appear at present to be supplying these products concurrently with container services, and already have existing spare capacity in those areas, the prospect of them profitably switching to supplying only these other services appears remote.

77. It is difficult to determine the geographic scope of this market, but the Commission recognises there are likely to be a number of regional markets in New Zealand.[35] Most ports have their own catchment areas, and ports are generally unable to attract bulky, low-value commodity exports from outside this area. However, for large amounts of New Zealand's exports, ports may be able to compete with one another for those volumes. For example, the Ports of Auckland and Port of Tauranga appear to compete for Fonterra's exports originating in Waikato. Port of Napier and CentrePort (in Wellington) appear to compete for products from the Manawatu and the Wairarapa. In this instance, the Commission does not consider it necessary to reach a firm conclusion on the exact parameters of each regional market. Rather, the Commission's competition analysis below focuses on a broad perspective of Kotahi's likely impact on containerised export port services from New Zealand, distinguishing regional variations where necessary.

Market for the procurement of intermodal services for containerised ocean freight

78. The Commission considers that another relevant market is that for the procurement of intermodal services for containerised ocean freight in New Zealand. For the purposes of assessing the current application, intermodal freight services are defined as including containerised domestic transport via road, rail and coastal shipping.

79. The Applicant submitted that the intermodal freight options of road, rail and coastal shipping should be considered as one discrete product market.[36]

80. The Commission has previously defined a single market for the supply of intermodal transport services in New Zealand.[37] However, as noted in that previous decision,

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35 The Commission has previously reached the view that there are regional markets for port services. *Port of Tauranga Ltd and Toll Holdings Ltd* (Commerce Commission Decision 533, 2004).

36 Application, at para 19.9.

37 *Port of Tauranga Ltd and Toll Holdings Ltd*, above n 35.

there is a large degree of product differentiation amongst road, rail and coastal shipping.[38]

81. For instance, road freight is generally more flexible and quicker than other modes, especially over shorter distances. Rail is generally cheaper over long distances, but is less flexible as it collects and delivers to fixed points.[39] Coastal shipping is sometimes used to transport bulky items over long distances, especially between islands. However, coastal shipping can be slower and less frequent than other options.

82. From a supplier perspective, if prices for any of these intermodal freight services decreased, they may be able to replace lost demand by getting customers to switch from another type of freight service. The degree of rivalry between providers is, however, difficult to ascertain.

83. For the purposes of this application, the Commission considers it sufficient to assess intermodal freight as one market. Disaggregating the market further, say by road, rail or coastal shipping, would be unlikely to have any impact on the Commission's competition assessment in this particular instance.

84. In terms of the geographic dimension, the Applicant submitted that separate North and South Island geographic markets may be appropriate, rather than a national market. Furthermore, the Applicant submitted that some regions may lack certain intermodal freight options, or those options may be more costly, suggesting a narrower geographic dimension.[40] The Commission's investigation has shown that many suppliers attract freight from numerous regions. If the price of freight went down in one region, suppliers may be able to switch to supplying more into another region. This may differ for local freight companies which focus on more localised catchment areas.

85. Nevertheless, for the purposes of this determination, the Commission has not considered it necessary to reach a definitive view on the geographic dimension of intermodal freight services.

Factual and counterfactual

86. To assess whether a lessening of competition is likely to result from the Kotahi arrangements, the Commission compares two hypothetical future situations, one with Kotahi (the factual) and one without (the counterfactual).

87. For the purpose of assessing this application, the factual is the future situation where Kotahi enters into the Kotahi arrangements with Fonterra, SFF and other limited partners and/or customers. These arrangements include the provisions, as outlined earlier, that relate to the Exclusivity Requirement, Pricing Mechanism, and Kotahi's negotiation of ocean freight rates

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38 Ibid, at para 98, "there is likely to be pockets of market power for particular products, locations, exporter/importer scenarios and transport modes (especially rail)."

39 Kotahi advised that rail typically becomes competitive over distances of around [ ] km. Commerce Commission interview with Kotahi (30 September 2011).

40 Application, at para 21.9.

88. The counterfactual is Kotahi continuing with Fonterra as the sole limited partner and without implementing the Kotahi arrangements.

89. The Applicant submitted that the scenario without the Kotahi arrangements would lead to either of the following occurring:[41]

    (a) some infrastructure investment being made by those largest ports but, without certainty of container throughput, no port becoming bigger ships capable within 5 years. That would occur only at a later date;

    (b) hubbing to bigger ships capable Australian ports becoming a reality, with only relatively small and old vessels continuing to provide a direct service.

90. The Commission has not found evidence to support the Applicant's submissions. The Commission considers the most likely counterfactual to be the status quo (with natural market developments). In such a scenario, ports are likely to continue to undertake planned investments, subject to outcomes arising from the Productivity Commission's inquiry into international freight transport services.[42] ICLs would also gradually increase the size of ships calling at New Zealand ports as the amount of containerised exports grows.

Analysis of the exemptions in s 44(2) of the Act and s 14 of the Shipping Act

91. The Commission considers that the Kotahi arrangements are unlikely to be exempt from Part 2 of the Act by virtue of s 44(2) of the Act or s 14 of the Shipping Act, as Kotahi does not provide for the physical carriage of goods.[43]

92. The Commission has considered whether all or part the Kotahi arrangements are exempt from the application of Part 2 of the Act due to certain exemptions for shipping activities (namely those found in s 44(2) of the Act and s 14 of the Shipping Act).[44] If either of these exemptions applies, the Commission considers it would be unable to authorise the arrangements to the extent that the exemptions applied. This is because the effect of the exemptions is that Part 2 does not apply to the conduct they cover, and so ss 27, 29 and 30 could never be triggered.

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41 Ibid, at para 22.13 and also see the Applicant's submission on the Draft Determination, above n 2, at paras 37-45.

42 The Commission has not assumed the possibility of law reform in the counterfactual. At this stage, law reform is too contingent in nature, timing and effect to be considered a likely counterfactual.

43 For the avoidance of doubt, if the Commission had found that all or part of the Kotahi arrangements were exempt from Part 2 of the Act by virtue of s 44(2) or s 14 of the Shipping Act, it is the Commission's view that it would not be able to grant an authorisation for arrangements which are exempt from Part 2. The Applicant raised the concern that any matters currently exempt may cease to be so in the future. As noted by the Applicant in its submission on the Draft Determination, the Productivity Commission has recommended in its draft report ("International Freight Transport Services - Draft Report" January 2012 at p 190) that exemptions for ratemaking and capacity-limiting agreements be removed. However, if and when the exemptions are removed, there would likely be transitional provisions and s 59A allows the Commission to consider authorising CAUs that have already been entered into or arrived at.

44 The Commission has given consideration to these issues notwithstanding that the Applicant does not rely on the exemptions.

Section 44(2) of the Act

93. Section 44(2)(a) of the Act exempts arrangements from Part 2 in so far as they contain provisions exclusively for the carriage of goods by sea from a place in New Zealand to a place outside New Zealand, or from a place outside New Zealand to a place in New Zealand.

94. The section excludes Part 2 from applying to contracts, arrangements or understandings (CAUs) that contain a provision "exclusively for" inwards and/or outwards shipping. Section 44(3) states that a provision is not "exclusively" for the carriage of goods by sea if it relates to the carriage of goods to or from a ship, or the loading or unloading of a ship.

95. In the Commission's view, the exception in s 44(2) of the Act does not apply to the Kotahi arrangements for the following reasons:

    95.1 The current arrangements do not contain severable provisions "exclusively" for the carriage of goods by sea.

    95.2 Rather the arrangements provide for the procurement and management ("pooling and coordination") of ocean freight carriage services (including any and all landside services) provided by the carrier.

96. In any event, the exemption in s 44(2)(a) relating to outwards shipping is arguably of no practical effect given that s 14 of the Shipping Act, which was enacted after s 44(2)(a), provides that Part 2 of the Act does not apply to outwards shipping.[45]

Section 14 of the Shipping Act

97. Section 14 of the Shipping Act exempts from Part 2 of the Act outwards shipping only.[46] Outwards shipping is defined in the Shipping Act as "the carriage of goods wholly or partly by sea from a place in New Zealand to a place outside New Zealand."

98. Section 14 of the Shipping Act is an awkward fit with s 44(2) of the Act. The Commission has considered some of the questions that arise from the term "outwards shipping" as it is defined in the Shipping Act. These are set out below:

    98.1 The Shipping Act does not restrict what 'a place in New Zealand' means, for example by confining it to being from a jetty or mooring. It could encompass carriage from a farm gate in Taupo, via Tauranga, to Beijing; a carriage partly by road or rail and partly by sea.

    98.2 A literal reading of s 14 – contrary to s 44(2)(a) of the Act – would exempt from the application of Part 2 provisions that relate to the carriage of goods

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45 Section 44 was amended in 1990, after the Shipping Act was enacted in 1987, but that amendment (the addition of s 44(3)) simply defined more precisely the scope of the exemption by explaining what "exclusively for the carriage of goods by sea" meant.

46 "Nothing in Parts 2 and 4 of the Commerce Act 1986 shall apply to outwards shipping" – s 14 of the Shipping Act.

by sea *together with* the precursor landside activities such as the transport of cargo to a port of departure (or indeed any coastal shipping).

98.3 On the other hand, a purposive approach that takes into account the historical purpose of shipping exemptions[47] and also the existence and more limited wording of the exemptions in ss 44(2) and (3) of the Act, would lead one to attempt to reconcile s 44(2) of the Act and s 14 of the Shipping Act. This could be done by construing s 14 of the Shipping Act's reference to "wholly or partly by sea" as being limited to the situation where goods leave New Zealand but transit partly by sea and, for instance, partly by air (or by some other mode after initial transit by sea).

98.4 Weighed against these considerations, however, is the existence in the Shipping Act of a mechanism to address the possibility of unfair trade practices. The Minister of Transport may investigate suspected unfair practices engaged in by shipping companies under s 5 of the Shipping Act.[48]

99. However, it is not necessary for the Commission to reach a view on the correct interpretation of the term, "outwards shipping". This is because the Commission's view is that the Shipping Act exemption, regardless of the meaning of the phrase "carriage of goods wholly or partly by sea", is unlikely to extend to activities that do not fundamentally relate to the *physical carriage* of goods.

100. Kotahi does not itself contemplate carrying goods by sea or any other means. Rather it would procure these services as part of a wider set of services that it is selling. The Applicant itself identified the distinction between procurement and the physical provision of outwards shipping as a potential issue for consideration.[49] In its Draft Determination, the Commission concluded that, it is unlikely that the exemptions would extend to the procurement or logistics management of the carriage of goods, as opposed to the provision of the physical carriage of goods, to the extent that procurement or management involve a separate intermediary function.

101. The Applicant submitted on the Draft Determination that "...the distinction between procurement and provision is not so clear-cut and in fact Kotahi will directly provide

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47 New Zealand Productivity Commission, above n 6, at p 35. "International liner shipping services traditionally operate under collaboration agreements…These arrangements have been to the benefit of shippers when they led to regular, scheduled services and carriers neither constrained their capacity nor exploited their market power. Until the late 1990s it was typical for countries to provide exemptions from domestic competition law for international shipping services in order to allow such arrangements." Also see New Zealand Productivity Commission "International Freight Transport Services Draft Report" January 2012 at pp 173-175.

48 The Applicant submitted that in practice the Ministerial regime has been in abeyance for some time and is generally regarded as "toothless". Application, at para 23.2.

49 See para 5.8 of the application where the Applicant discusses "*procurement* of carriage of goods v *provision* of carriage of goods" in the context of s 44(2) of the Act and the Applicant's submission on the Draft Determination , above n 2, at para 23.

some ocean freight services."[50] The Applicant emphasised paragraph 5.15 of the Application which states:

> Kotahi Logistics will itself purchase vessel space from shipping providers to meet its limited partners' and other customers' requirements.

102. The Commission considered this submission, but has not changed its view on the meaning of the exemptions and their application. In the Commission's view, "procurement or management" of the carriage of goods would also likely encompass purchasing vessel space on behalf of limited partners and customers, as opposed to being the "provision" or "physical" carriage of goods.

103. In reaching this conclusion, the Commission has also considered the Applicant's submission referring to the Productivity Commission's International Freight Transport Services Draft Report.[51] As noted by the Applicant, the Productivity Commission has recommended that New Zealand should retain an exemption for non-ratemaking agreements, which includes vessel sharing agreements.[52] The Applicant has submitted that:[53]

> It seems a fine line to draw that vessel space obtained by one carrier swapping or leasing capacity from another should be covered by the exemption; while vessel space similarly obtained by Kotahi should not.

104. In the Commission's view, any purchase of vessel space by Kotahi on behalf of its limited partners/customers is not the same as a vessel sharing agreement[54] whereby ICLs jointly operate containerised ocean freight services. In our view, Kotahi is not an ICL. Kotahi is a provider of freight logistics and management services and in accordance with the historical purpose discussed above, *ICLs* are exempt from the full application of domestic competition laws.

105. As outlined in the market definition section, in the Commission's view, the freight logistics and management services to be provided by Kotahi are in a different market than the physical carriage of goods. This market definition analysis supports the Commission's view that neither of the exemptions in s 44(2) of the Act and s 14 of the Shipping Act applies to the Kotahi arrangements.

Analysis of s 29

106. The Commission's view is that the Kotahi arrangements are unlikely to contain any exclusionary provisions to which s 29 of the Act may apply. Having found no

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50 Applicant's submission on the Draft Determination, above n 2, at para 17.1.

51 New Zealand Productivity Commission "International Freight Transport Services Draft Report" January 2012.

52 Non-ratemaking agreements are also known as consortia or operational agreements and include cooperative working agreements, equipment interchange agreements, sailing agreements and vessel sharing agreements.

53 Applicant's submission on the Draft Determination, above n 2, at para 28.

54 The Productivity Commission, above n2, at page 173, define 'vessel sharing agreement' as an agreement between two or more ocean carriers regarding sharing of vessel space (space or slot charters and/or swaps).

exclusionary provision, the Commission decision is to decline the application to authorise the Kotahi arrangements under ss 58(5) and (6) of the Act.

107. Section 29 of the Act prohibits competitors from entering into or giving effect to agreements containing exclusionary provisions. The Commission may authorise exclusionary provisions under s 61(7) of the Act where it is satisfied that giving effect to the exclusionary provision will in all the circumstances result, or be likely to result, in such a benefit to the public that the provision should be permitted.

108. To assess applications under ss 58(5) and 58(6) of the Act, the Commission first determines whether the arrangement contains, or may contain, an exclusionary provision under s 29(1) of the Act.

109. Under s 29(1) of the Act, an exclusionary provision will be found if:

109.1 It is part of an arrangement between parties who are in competition with each other – (s 29(1)(a)).

109.2 It has the purpose of preventing, restricting or limiting the supply of goods or services to, or their acquisition from, a person or class of persons, by all or any of the parties to the arrangement – (s 29(1)(b)).

109.3 The person or class of persons that the provision relates to is in competition with one or more of the parties to the arrangement – (s 29(1)(c)).

110. Where there is no real risk that s 29 will apply to the conduct, because there is no reasonable possibility that it involves an exclusionary provision under s 29(1), the Commission declines the application made under ss 58(5) and 58(6). In that event, the Commission does not go on to consider whether the benefits of the exclusionary provision outweigh any lessening of competition.

111. However, if the Commission finds that there would or could be an exclusionary provision under s 29(1), it will then assess whether the exclusionary provision will in all the circumstances, result, or be likely to result, in such a benefit to the public that it should be permitted.

Section 29(1A) defence does not change the approach

112. Section 29(1A) of the Act provides that a provision that satisfies the definition of an exclusionary provision under s 29(1) of the Act, is not an exclusionary provision if it is proved that the provision does not have the purpose, or effect or likely effect, of substantially lessening competition in a market.

113. The Commission does not consider that the insertion of s 29(1A) necessitates a departure from the Commission's approach to authorisation applications prior to the amendment to s 29 of the Act.[55] As discussed in *Refrigerant Licence Trust Board*,[56] in

[55] See *Weddel NZ Ltd* (Commerce Commission Decision 273, 1995) and *Newcall Communications Limited and others* (Commerce Commission Decision 356, 1999), which were decided before subs (1A) was inserted into the Act on 26 May 2001.

the context of considering an application for authorisation under ss 58(5) and 58(6), the Commission considers that the relevant threshold enquiry continues to be focussed on whether the proposed conduct risks being caught under s 29(1), without reference to the defence available under s 29(1A).

114. As noted in *Refrigerant Licence Trust Board*, firstly, the articulation of the benefits test under s 61(7) of the Act appears aligned with the per se nature of s 29(1) and does not contain language reflective of the analysis that might be required under s 29(1A). A specific reference in s 61(7) to a lessening of competition as a factor to weigh against benefits might have been expected if Parliament intended that the defence in s 29(1A) be the subject of threshold evaluation by the Commission.[57]

115. Secondly, if the Commission engaged in a s 29(1A) analysis as a threshold matter, it would have to satisfy itself about the extent, or substantiality, of any lessening of competition arising from the exclusionary provision. Such an onus on the Commission in the authorisation context, is not warranted given that s 29(1A) is intended to be a matter of proof for a defendant in the context of proceedings before the courts. Rather, the extent of any lessening of competition arising from conduct that is caught by s 29(1) will be considered by the Commission in its detriments analysis.

116. Thirdly, the Commission considers that its interpretation of ss 29 and 61(7) supports and reflects the important policy preference that applicants are not denied the intended protections of authorisation where justified.

Do the Kotahi arrangements contain an exclusionary provision?

117. The Commission considers that the Kotahi arrangements are unlikely to contain an exclusionary provision that satisfies the definition in s 29(1).

118. Clause 4.1 of the LPA states:

> **Initial Limited Partners' Commitment to enter into Services Agreements**
> On or before the date of this Agreement, each Initial Limited Partner will, unless it has already done so, enter into (or arrange for its Affiliate to enter into) a Services Agreement, under which that Initial Limited Partner will exclusively commit to procure all of its ocean freight services requirements from the Limited Partnership.

119. Fonterra has queried whether this Exclusivity Requirement may be in breach of s 29.[58]

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56 *Refrigerant License Trust Board* (Commerce Commission Decision 735, 2011), at paras 39-44.

57 This view is consistent with the commentary expressed in Gault that a lessening of competition is not mentioned as a detriment in s 61(7) "because this is not required to be shown for a contravention of s 29." See *Gault on Commercial Law* CA61.04 (3).

58 Application, at para 5.18. This is on the basis that (i) Kotahi's limited partners and customers compete with each other to acquire ocean freight services, (ii) the provisions of the arrangement have the purpose of preventing the acquisition of such services from a class of persons, i.e. directly from the carriers or from carriers that Kotahi Logistics does not purchase from and (iii) these persons indirectly compete with Kotahi Logistics in that they could supply their services to the limited partners directly.

120. For a provision to breach s 29 it must meet all three limbs of s 29(1). These three limbs are discussed below.

The parties are in competition with each other (s 29(1)(a))

121. The Commission considers that the parties to the Kotahi arrangements (Fonterra and SFF) are "in competition" with each other.

122. The competition enquiry is not related to competition in the market as a whole but to whether parties are "competitive".[59] At certain times of the year due to the seasonality of certain products, demand for container space on ships increases. It is particularly during these times that Fonterra and SFF compete, alongside other exporters and importers, for the acquisition of container space on ICLs.

123. The Commission finds that Fonterra and SFF (and other exporters and importers who agree to use Kotahi's services) are notionally "competitors" in relation to the acquisition of the ocean freight services that Kotahi would procure for them. Fonterra, SFF and other future limited partners or customers of Kotahi are not, however, as discussed above, in competition with each other for the supply of management services for containerised ocean freight.

The purpose of the provision is not to restrict the supply to, or acquisition of services from, any particular person or class of persons (s 29(1)(b))

124. In the Commission's view, the purpose of the Exclusivity Requirement is to ensure that Kotahi's limited partners contract exclusively with Kotahi for management of their ocean freight service requirements. This enables Kotahi to in turn negotiate with ICLs on the basis of aggregated volumes. It is not the purpose of the provision to restrict the acquisition of actual ocean freight services from any particular ICL or any other person or class of persons. Rather, it is in the interests of Kotahi's limited partners and customers that the full range of ocean freight service providers be available to them. Therefore the Exclusivity Requirement does not meet the requirements of s 29(1)(b).

125. The Act is concerned with the purpose, not the effect, of exclusionary provisions. As long as an anti-competitive purpose is a substantial one, it can be one of a number of purposes – see s 2(5) of the Act. The word "purpose" is, however, undefined in the Act. The main debate is whether, under the Act, purpose is to be ascertained objectively or subjectively. In *ANZCO Foods Waitara Ltd v AFFCO New Zealand Limited*[60] Glazebrook J and William Young J differed as to whether purpose is to be assessed subjectively or objectively. Glazebrook J considered that purpose is to be assessed objectively, but that evidence of subjective purpose can be taken into

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[59] Warren Pengilley "The Exclusionary Provisions of the New Zealand Commerce Act in light of United States Decisions and Australian Experience" (1988) 3 Canterbury Law Review 357 at 378, "...some may regard this enquiry as *per se* answered by the proposition that the parties would not enter into a collective boycott arrangement unless at least two of them were competitive with each other."

[60] Glazebrook J in *ANZCO Foods Waitara Ltd v AFFCO New Zealand Limited* [2006] 3 NZLR 351. Adopting the point made by McGrath J in *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608.

account in that assessment.[61] However, as noted by Glazebrook J "...anything other than an objective ascertainment of purpose does not fit in with the per se provisions, such as ss 29 and 30....It would be contrary to the intended mischief to which those provisions are aimed if a party were able to escape liability for conduct that is prohibited absolutely, on the basis of a subjective ascertainment of purpose."[62] William Young J observed that a better approach might be to assess purpose objectively by reference to its actual or likely effect should it be acted on.[63] Although Glazebrook J and William Young J differed as to the weight to be given to the competing factors relevant to the assessment of purpose, they were broadly in agreement that purpose is primarily (perhaps preferably) to be assessed objectively. However, subjective evidence of anti-competitive purpose is relevant to the assessment.[64]

126. The Applicant submitted that ICLs are potentially excluded by the Exclusivity Requirement. This is on the basis that the Exclusivity Requirement has the purpose of preventing the acquisition of ocean freight services from a class of persons (directly from ICLs or from ICLs that Kotahi does not purchase from).[65] The objective purpose of the Exclusivity Requirement is informed by its foreseeable effects.

127. The Commission considers that those effects are merely that Kotahi's limited partners would contract exclusively with Kotahi for management of their ocean freight service requirements. It is not the purpose of the provision to restrict the supply or acquisition of ocean freight services to or from any particular person or class of persons. Indeed, under the Kotahi arrangements, ocean freight services would continue to be supplied by ICLs for the benefit of limited partners and customers of Kotahi. The only difference is that the supply and acquisition would be negotiated by Kotahi.

128. Absence of the requisite purpose is reinforced by the fact the Exclusivity Requirement makes no reference to an excluded person or class of persons and to that extent lacks the flavour of a collective boycott to which s 29 is directed. Rather, the Exclusivity Requirement is simply expressed as an obligation to contract exclusively with Kotahi.

129. In the Commission's view, an exclusionary provision cannot be aimed generally. This is consistent with the Commission's view in past authorisation decisions. In *Insurance Council of New Zealand*,[66] the Commission was of the view that the "[a]greement excludes the supply of nuclear risks insurance to all persons and does not distinguish between classes of persons. It does not therefore meet the criterion of due

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61 Ibid, at para 261.
62 Ibid, at para 260.
63 Ibid, at para 143.
64 Ibid, at paras 142 and 255.
65 Application, at para 5.18.
66 *Insurance Council of New Zealand (Inc)* (Commerce Commission Decision 244, 1990).

particularity set out in s 29(1)(b). Accordingly, the Commission does not consider this to be a practice to which s 29 of the Act applies."[67]

130. In *Todd Pohokura Ltd v Shell Exploration NZ Ltd*[68] the plaintiff alleged that the purpose of the gas off-take (ie the removal of a given quantity of gas from the system) agreements was to limit production and supply of Pohokura gas, thereby preventing, restricting or limiting the supply of gas by one or more of the parties to actual and potential wholesale purchasers of Pohokura gas. Dobson J held that the absence of any targeted element in the off-take documents takes the conduct complained of outside of what is rendered unlawful by s 29. Dobson J said in relation to the particular facts that "...any limitation on supply is indiscriminate. That counts against the provision applying."[69] Any limitation that limits supplies to the whole of the market is also indiscriminate: "....the mischief addressed by the section is inherently discriminatory to keep one or more persons out of a market."[70]

131. Contrary to the Applicant's submission, in the Commission's view, it is not clear who the Exclusivity Requirement is directed at, if anyone. As noted in *Todd Pohokura*, the mischief addressed by s 29 is action that keeps an identifiable person or class of persons out of the market. ICLs are unlikely to be an intended target for exclusion. Kotahi would continue to procure from ICLs, on behalf of its limited partners and customers, services for containerised ocean freight. As noted above in the market definition section, Kotahi will supply ocean freight management services. However, it will not compete with ICLs in the provision of the physical carriage of those goods. Therefore, there will be no reduction of freight volumes available for ICLs to carry.

132. There is nothing in the Kotahi arrangements that stipulates from whom Kotahi would procure its services for containerised ocean freight. Nor do the Kotahi arrangements detail the terms of any such purchases, such as exclusivity or length of contract. Kotahi has advised it is likely to procure services from a range of ICLs.[71]

133. Although it is not apparently a concern raised by the Applicant, the Commission also notes that freight forwarders or other providers of ocean freight management services, including ICLs as may be the case, are not apparently targets or excluded by the Exclusivity Requirement. Such persons may continue to compete with Kotahi to provide management services for containerised ocean freight to (a) exporters and importers outside of the Kotahi arrangements, (b) to exporters and importers who are customers of Kotahi[72] or (c) to limited partners of Kotahi either prior to those limited partners entering into a Services Agreement with Kotahi or by persuading limited partners to exercise their option to exit the partnership.

134. Accordingly, the Commission is not satisfied that s 29(1)(b) has been met.

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67 Ibid, at para 28.

68 *Todd Pohokura Ltd v Shell Exploration NZ Ltd* HC Wellington CIV-2006-485-1600, 13 July 2010.

69 Ibid, at 492.

70 Ibid.

71 Commerce Commission interview with Kotahi (30 September 2011).

72 Customers of Kotahi do not have to exclusively commit to procure all of their ocean freight service requirements from Kotahi.

Target of the provision is "in competition" with at least one of the parties (s 29(1)(c))

135. Subsection (c) was inserted in 1990 and "…introduced a significant limitation changing the general thrust of the section so that it now is limited to circumstances in which the person against whom the exclusion may operate is in competition with one of the parties to the CAU."[73]

136. In the Commission's view it is not the purpose of the provision to restrict the acquisition of actual ocean freight services from any particular person or class of persons and it is not clear against whom the Exclusivity Requirement is directed. The Commission has therefore not reached a definitive view on s 29(1)(c). However, in the event that it could be shown that ICLs were the class of persons against whom the Exclusivity Requirement is directed, the Commission's view, as discussed above, is that the targets of the provision (ie ICLs in this scenario) are not in competition with Kotahi for the supply of management services for containerised ocean freight.

Analysis of s 30

137. This section explains the Commission's view that the Kotahi arrangements are unlikely to contain price fixing provisions under s 30. Having found no price fixing provision, the Commission does not consider s 30 any further and does not go on to consider the benefits and detriments of the arrangements.

138. Section 30 deems provisions that have the purpose, or effect or likely effect, of fixing, controlling or maintaining the price of goods or services to substantially lessen competition under s 27. Such provisions can be authorised under s 61(6) of the Act if the Commission is satisfied that the entering into or giving effect to the provision of the CAU, will in all the circumstances result, or be likely to result, in a benefit to the public which would outweigh the actual lessening of competition.

139. The Commission first determines whether the arrangement contains, or may contain, a price fixing provision under s 30 of the Act.

140. Under s 30 of the Act, a price fixing provision will be found if both of these limbs are met:

    140.1 It has the purpose, or effect or likely effect, of fixing, controlling or maintaining the price of goods or services or any discount, allowance, rebate or credit in relation to goods or services.

    140.2 The goods or services are supplied or acquired by the parties to the CAU who are in competition with each other.

141. If the Commission considers that the conduct is unlikely to breach s 27 via s 30 and/or is exempted from s 30 by operation of ss 31 or 33, the Commission does not consider any further an application for authorisation under this section of the Act.

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[73] *Tui Foods Ltd v NZ Milk Corp* (1993) 5 TCLR 406 per Gault J at p 3.

142. However, in the event there is a deemed lessening of competition, the Commission goes on to assess whether the conduct would, in all the circumstances, result, or be likely to result, in a benefit to the public which would outweigh the actual lessening of competition. If the benefits outweigh the lessening of competition, the Commission may grant an authorisation. Despite the deeming effect of s 30, in the authorisation context, the Commission must determine the actual degree of lessening of competition which arises from the conduct to which s 30 applies.[74]

Exemptions from the price fixing prohibition

143. The Act includes joint venture (s 31), price recommendation (s 32) and joint buying (s 33) exemptions to the per se prohibition against price fixing (s 30). If one of these exemptions applies to the Kotahi arrangements, the arrangements are exempt from the application of s 30. However, even if all or part of an exemption applies, this does not dispose of the question of whether s 27 of the Act may apply directly to the Kotahi arrangements.

Do the Kotahi arrangements contain a price fixing provision?

144. The Commission considers that the Kotahi arrangements are unlikely to contain price fixing provisions under s 30, nor do the arrangements have the effect of fixing price for the purposes of s 30.

145. In the Applicant's view there are three ways in which the Kotahi arrangements may contain provisions that contravene s 27 via s 30. These are discussed below.

145.1 Pricing Mechanism[75] – By fixing, controlling or maintaining the price at which Kotahi would charge its limited partners and customers for acquiring the ocean freight management services of Kotahi. Kotahi would supply management services for containerised ocean freight to its limited partners and customers. Kotahi would charge its limited partners and customers an overall fee for managing these services based on an agreed Pricing Mechanism set out in the LPA. The Applicant submitted that the Pricing Mechanism may be in breach of s 27 via s 30 on the basis that it has the purpose and effect of providing for the fixing, controlling or maintaining of the prices for ocean freight management services acquired by limited partners and customers.[76]

145.2 Negotiation of containerised ocean freight rates[77] – By controlling or maintaining the price at which Kotahi would purchase ocean freight services from ICLs on behalf of its individual limited partners and customers. Kotahi would jointly negotiate containerised ocean freight rates with ICLs on behalf of its limited partners and customers.[78] The Applicant submitted that the joint

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74 *New Zealand Vegetable Growers Federation (Inc) v Commerce Commission (No.3)* (1988) 2 TCLR 582 at p 12.

75 Clause 4.8 of the LPA, above n 11.

76 Application, at para 5.18.

77 Referred to by the Applicant as "the overall arrangements". Application, at para 5.18.

78 Clause 3 of the Establishment Agreement.

negotiations may have the effect of controlling the price of services acquired from ICLs and therefore may be in breach of s 27 via s 30 of the Act.

145.3 Procurement of intermodal freight services – The arrangements establishing Kotahi (provisions in the LPA and the Constitution) are likely to have the effect of fixing, controlling or maintaining the price at which Kotahi procures intermodal freight services. Kotahi intends to supply intermodal services for containerised ocean freight to its limited partners and customers as set out in schedule 2 of the LPA. The Applicant submitted that clause 5 of the LPA and clauses 43 and 44 of the Constitution would provide the limited partners with a mechanism to control the price at which Kotahi procures the intermodal freight services.[79]

Pricing Mechanism

146. In the Commission's view, s 30 is unlikely to apply to the Pricing Mechanism as the "in competition" requirement in s 30(1)(a) has not been met. However, if this view is incorrect, the Pricing Mechanism is exempt from the application of s 30 in any event, because Kotahi supplies management services for containerised ocean freight as a joint venture for the purposes of s 31(1).

147. Section 30(1)(a) requires that the parties to the price fixing provision be "in competition with each other" for the supply of services that are the subject of the provisions. Therefore there must be a horizontal dimension to the arrangement for s 30 to apply. For s 30 to apply to the Pricing Mechanism, the management services must be supplied by parties to the CAU who are in competition with each other or who, but for the arrangement, would be in competition with each other.

148. To determine whether parties are in competition with each other calls for some type of competition analysis. The question arises as to what is the nature and extent of the analysis, and specifically, whether a market definition is required. In *Commerce Commission v Air New Zealand Ltd*,[80] the High Court held that if the s 30 deeming provision applies and there is no suggestion that the market is outside New Zealand, no market definition exercise is required under s 30:[81] "...[w]here parties are required to be "in competition with each other", a market is not an element required to be proven. Competition is to be understood in its descriptive or relational sense."[82] The High Court went on to say, "[n]evertheless in a s 30 case the parties will, in fact be competing in a market. The market will be the market for the supply or acquisition of goods or services the subject of the price fixing arrangement. That will be the market in which a substantial lessening of competition is deemed for the purposes of s 27."[83]

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79 Letter from Grant David, above n 12, at para 23.

80 *Commerce Commission v Air New Zealand*, above n 32, at para 76.

81 Ibid.

82 *Commerce Commission v Air New Zealand,* above n 32 at para 83.

83 Ibid, at para 85.

149. The parties to the CAU do not compete with each other to supply management services for containerised ocean freight, as neither Fonterra nor SFF offer those services. These are the services to which the Pricing Mechanism relates and therefore the services in respect of which the parties must be in competition in order for s 30 to apply.[84] Nor do prospective limited partners or customers of Kotahi provide management services for containerised ocean freight. Rather, it is the precise innovation of the Kotahi arrangements that such services will begin to be provided by a joint venture entity, Kotahi. It is therefore the Commission's view that the Pricing Mechanism is unlikely to be a price fixing provision for the purposes of s 30.

Section 31 – the joint venture exemption

150. Even if the Pricing Mechanism were held to be a price fixing provision under s 30 (contrary to the Commission's view), the Commission considers that the Pricing Mechanism would be exempt from the application of s 30, as Kotahi is a joint venture for the purposes of s 31(1).

151. Section 31 exempts from the s 30 deeming rules certain price fixing provisions in CAUs between parties to a joint venture.

152. Under s 31(1), only two types of joint ventures are eligible for exemption, being (i) those carried on by 2 or more persons, whether or not in partnership (unincorporated joint ventures) or (ii) those carried on by a body corporate (incorporated joint ventures). The further criteria for meeting the joint venture exemption differ depending on the type of joint venture at issue.

153. The Applicant submitted that s 31 may provide an exemption to the Pricing Mechanism as clause 4.8 of the LPA relates to the supply by Kotahi of ocean freight management services in pursuance of the joint venture.[85]

154. In the Commission's view, Kotahi is a joint venture for the purposes of s 31. Kotahi is a limited partnership and therefore a body corporate for legal purposes. Once registered, a limited partnership is a separate legal person.[86] Kotahi is therefore an incorporated joint venture for the purposes of s 31(1). Kotahi itself (and not its limited partners) will supply management services for containerised ocean freight in pursuance of the joint venture (s 31(2)(c)(ii)).

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84 As discussed above, the Commission considers that the parties can be taken to compete with one another for the acquisition of containerised ocean freight services. However, that activity is not the target of the Pricing Mechanism. The application of s 30 to the acquisition of containerised ocean freight services is discussed below.

85 Application, at para 5.18.

86 Section 11 of the Limited Partnerships Act 2008.

155. In its analysis of s 31, the Commission also considers whether Kotahi is a genuine joint venture. Jurisprudence[87] has established the following criteria (and others, not relevant here) which can be used to carry out this analysis:

155.1 Whether the joint venture is likely to create significant new enterprise capability in terms of new productive capacity, new technology, new product or entry into a new market.[88]

155.2 Whether there is a substantial, even if not total, integration of production, managerial, distribution, financial and other operations.[89]

155.3 Whether the objectively intended purpose or likely effect of the joint venture is lower prices or increased output as measured by quantity or quality.[90]

156. It appears to the Commission that the Kotahi joint venture is bona fide and is not being used as a cloak for price fixing. Kotahi has been created to act as a freight forwarder for large exporters and importers. This is a new service[91] or, at the very least, there appear to be few freight forwarders or other entities who participate in this particular market niche – existing freight forwarders typically service small volume exporters and importers, who often have an ocean freight requirement of less than a full container. The joint venture is to be self-financing [ ].[92] The essence of Kotahi is to reduce costs for its limited partners and customers.

157. Therefore, if the Pricing Mechanism is held to be a price fixing provision under s 30 (contrary to the Commission's view), the Commission considers that the Pricing Mechanism would be exempt from the application of s 30, as Kotahi is a joint venture for the purposes of s 31(1).

Negotiation of containerised ocean freight rates[93]

158. In the Commission's view, Kotahi's negotiations with ICLs for containerised ocean freight rates are unlikely to be considered price fixing under s 30.

159. To fall within s 30, the negotiations for containerised ocean freight rates must have the purpose, or effect or likely effect, of "fixing, controlling or maintaining" the price of such services. As set out in the Establishment Agreement and the Services Agreement:

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87 Case law and commentators support the position that entry into a joint venture will or may change the status of competitors from being parties "in competition with each other" under s 30 to being joint venturers who are not "in competition with each other".

88 Alan Lear "Joint Ventures: Treatment under New Zealand, United States and European Competition Law" (2005) 11 NZBLQ 187.

89 Warren Pengilley, "Thirty years of the Trade Practices Act: Some thematic conclusions" (2004) 12 CCLJ 6 at 45.

90 Areeda & Havenkamp *Anitrust Law* at 1906a.

91 On the ocean freight management side, it is a service that parties to the arrangement do not currently supply.

92 Application, at para 17.8.

93 Referred to by the Applicant as "the overall arrangements". Application, at para 5.18.

159.1 The interim limited partnership would begin negotiations with ICLs and the General Partner would consult with SFF on any aspect of the negotiations.[94]

159.2 The ICL negotiations would be conducted on the basis that both Fonterra's and SFF's cargo volumes would be available to Kotahi in order to obtain the best available price and terms from the shipping providers.[95]

159.3 Kotahi would endeavour to negotiate the most favourable commercial terms reasonably available with ICLs.[96]

160. Kotahi would be negotiating freight rates on behalf of its limited partners and customers. Fonterra and SFF must consult with each other in relation to the negotiations with ICLs. The Applicant submitted that the negotiation arrangements may have the effect of providing for the fixing, controlling or maintaining of the price at which Kotahi would purchase services for containerised ocean freight on behalf of the individual limited partners and customers.[97]

161. In the Commission's view the most relevant term to consider in this situation – where the provision is merely one that aggregates buyer power as opposed to setting out a formula for the determination of prices – is "controlling". The role of the word "control" is to ensure that the ban on price fixing extends to arrangements, which while not prescribing any agreed price or uniform method for computing it, nevertheless interfere with the competitive determination of price.[98]

162. Salmon J in *Commerce Commission v Caltex NZ Ltd*[99] noted that amongst the definitions of the word "control" in the *Shorter Oxford English Dictionary* is the phrase "to exercise restraint or direction upon the free action of".

163. The price for acquiring services for containerised ocean freight from ICLs is not regulated in any way, and there are no rules in the Kotahi arrangements that fix, control or maintain the price for acquiring such services from ICLs. Rather, the arrangements only provide that Kotahi would negotiate prices with ICLs on behalf of its limited partners and customers. The Kotahi arrangements are many steps removed from the kinds of provisions considered under s 30 in prior decisions. In *New Zealand Grape Growers Council Incorporated*[100] authorisation was sought for specific contractual provisions: eg a Committee would be established before each vintage to determine a "base price per acre" for that vintage and "prices for each variety" of grape. The Commission concluded that s 30 applied to the joint committee pricing provisions and associated arrangements or understandings.

164. In the Commission's view, it is difficult to see how Kotahi's intended negotiations with ICLs would differ significantly from those currently undertaken by, for instance,

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94 Clause 3 of the Establishment Agreement.
95 Recital E and clause 3 of the Establishment Agreement.
96 Clause 2.4 of the Services Agreement.
97 Application, at para 5.18.
98 *Gault on Commercial Law*, CA30.08 (1).
99 *Commerce Commission v Caltex NZ Ltd* (1999) 9 TCLR 305 at 311.
100 *The New Zealand Grape Growers Council Incorporated*, above n 17.

freight forwarders on behalf of their clients. It is accepted that the volume of cargo for which Kotahi would be procuring containerised ocean freight may be larger than that managed by most freight forwarders. It is also expected that Kotahi may have more bargaining power with ICLs than would its limited partners and customers negotiating individually. However, the combined negotiating power of Kotahi's limited partners and customers is not, by itself, likely to control the price at which services for containerised ocean freight are acquired. This is especially so given the uncertainty as to how many exporters and importers would ultimately participate in Kotahi as limited partners or customers. In the circumstances, the relevant assessment of Kotahi's buying power properly falls under s 27 (discussed further below).

165. In the absence of a price fixing provision in the Kotahi arrangements that is collectively agreed between the limited partners and customers of Kotahi, all that remains is the transactional negotiation of price on a case-by-case basis with ICLs by Kotahi, a unitary corporate entity established by the joint venture. The conduct of such case-specific negotiations therefore occurs in a standard vertical arrangement between supplier and acquirer such that s 30 can have no application.

166. For the foregoing reasons, the Commission's view is that the negotiation of containerised ocean freight rates (or the effect of the overall arrangement, as referred to by the Applicant) is unlikely to be considered price fixing under s 30 of the Act.

Section 33 – the joint buying exemption

167. Despite its view noted above that s 30 does not apply on its merits, the Commission has nonetheless considered whether the joint buying exemption in s 33 might in any event exempt the Kotahi arrangements from the application of s 30. Section 33 provides that nothing in s 30 applies to a provision of a CAU that relates to the price for goods or services to be collectively acquired, whether directly or indirectly, by parties to the CAU.

168. "Collectively" is not defined in the Act but it has been observed that "...it is probably sufficient if, for example, members of a buying group use their combined bargaining power to negotiate a common purchase price but then place their own orders separately."[101] This is not the type of situation here, as there will not be a common purchase price and Kotahi will place all orders with ICLs for ship space.

169. The collective acquisition may be effected either "directly or indirectly". However, as noted in *TPC v Legion Cabs (Trading) Co-op Soc Ltd*[102] by Franki J, an indirect acquisition is one through an agent. Where an intermediary takes title to the goods or services, and sells them in his or her own right there is no indirect supply by the

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101 Miriam R Dean, "Collective Pricing – A Practical Guide to Section 30 of the Commerce Act 1986" (1990) 20 VUWLR 1 at 17 citing Taperell, Harland & Vermeesch, *Trade Practices and Consumer Protection* (Butterworths, Sydney, 1983), para 574.

102 *TPC v Legion Cabs (Trading) Co-op Soc Ltd* (1978) ATPR 40-092 at paras 27 and 28.

original supplier to the ultimate acquirer. As noted in *Gault on Commercial Law*[103], it would be prudent therefore, for the buying group to arrange to acquire title to the goods or services and resell to individual members.

170. It is therefore not clear whether s 33 was intended to apply to a situation such as the one before the Commission. The Applicant submitted that it is questionable whether the s 33 collective acquisition exemption would apply to exempt the overall arrangement from the application of s 30. This is because the rates at which services are purchased by Kotahi from the ICLs [ ].[104] This may count against the services for containerised ocean freight being considered as "collectively acquired".

171. At this stage it is not necessary for the Commission to reach a definitive conclusion on the application of s 33, in light of the Commission's finding that Kotahi's negotiations with ICLs on behalf of its limited partners and customers are unlikely to amount to price fixing under s 30.

Procurement of intermodal freight services

172. In the Commission's view, clause 5 of the LPA and clauses 43 and 44 of the Constitution are unlikely to have the purpose, or effect or likely effect, of fixing price within the meaning of s 30.

173. To fall within s 30, the procurement of intermodal freight services must have the purpose, or effect or likely effect, of "fixing, controlling or maintaining" the price of such services. Clause 5 of the LPA sets out the rights and duties of the Kotahi partners. Clauses 43 and 44 of the Constitution set out the decisions that require a special resolution of shareholders or an extraordinary director's resolution.

174. The Applicant submitted that by entering into the LPA and Constitution, SFF and Fonterra (and other potential limited partners) would be entering into a contract that provides limited partners with a mechanism by which they can control the price at which Kotahi acquires intermodal services for containerised ocean freight.[105]

175. For reasons, similar to those noted above regarding the negotiation of rates for containerised ocean freight, it is difficult to see how clauses in the LPA and Constitution have the ability to interfere with the competitive determination of price for intermodal freight services.

176. In the absence of a price fixing provision in the Kotahi arrangements that is collectively agreed between the limited partners and customers of Kotahi, all that remains is the transactional negotiation of price on a case-by-case basis with intermodal freight providers by Kotahi. The conduct of such case-specific negotiations therefore occurs in a standard vertical arrangement between supplier and acquirer such that s 30 can have no application.

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103 *Gault on Commercial Law*, CA33.01 (2).

104 Application, at para 5.18.

105 Letter from Grant David, above n 12, at para 23.

177. For these reasons, the Commission's view is that clause 5 of the LPA and clauses 43 and 44 of the Constitution are unlikely to have the purpose, effect or likely effect, of fixing, controlling or maintaining the price for intermodal freight services within the meaning of s 30.

Analysis of s 27

178. This section explains the Commission's view that s 27 is unlikely to apply to the Kotahi arrangements in that there will not be a lessening of competition in the relevant markets. Therefore, the Commission must decline the application for authorisation in respect of s 27.

179. The Applicant submitted that s 27 might apply to Kotahi's arrangements if it leads to an SLC in the containerised ocean freight market because:[106]

179.1 Depending on the freight volumes of its limited partners and customers that Kotahi is able to aggregate (the Exclusivity Requirement applying to limited partners only) there may be sufficient foreclosure of ICLs.

179.2 The Pricing Mechanism may provide for the fixing, controlling or maintaining of Kotahi's charges to its limited partners and customers.

179.3 Clause 3 of the Establishment Agreement provides for the joint negotiation of freight rates by Kotahi and may provide for the fixing, controlling or maintaining of the rates at which Kotahi would procure services for containerised ocean freight from the ICLs.

180. Fonterra has not requested authorisation for intermodal freight services in respect of a potential breach of s 27. Therefore the Commission does not consider intermodal freight services any further in this section.

181. Section 27 of the Act prohibits CAUs that have the purpose, or effect or likely effect, of substantially lessening competition in a market. The Commission can authorise conduct that is anti-competitive under s 27 of the Act. To do so, the Commission must be satisfied that the anti-competitive conduct would result in a benefit to the public that would outweigh the lessening of competition.

182. In assessing an application under s 27, the Commission first determines whether the conduct would or might reasonably result in a lessening of competition. Under s 61(6A) of the Act, when considering an application for authorisation the lessening of competition need not be substantial. Section 3(1) of the Act defines competition to be "workable or effective competition" as opposed to the theoretical notion of perfect competition. A lessening of competition is defined in s 3(2) of the Act to include the hindering or preventing of competition. In *Commerce Commission v Port Nelson Ltd*, McGechan J noted the extended definition of the term lessening.[107]

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106 Application, at para 5.18.

107 *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406.

> One may or may not, normally, 'lessen' when one 'hinders'. The word 'hinder' (*Shorter English Dictionary* (3rd ed), vol 1, p 865) covers senses which include 'do harm to' and 'prevent'; but also to 'keep back, impede, deter, obstruct', and 'delay or frustrate action, by an obstacle or impediment'. One can 'hinder' by merely delaying or obstructing for the immediate time. That, no doubt, is the extended sense intended. There would be little point, otherwise, in the extension. The inclusion of 'hindrance', in that sense accords entirely with the overall policy of the Act to remove obstacles in the way of free competition.

183. Case law and commentary tend to focus on what constitutes a SLC, as that is the applicable anti-competitive threshold for breaching key substantive provisions of the Act, ie ss 27 and 47. What constitutes a mere *lessening* of competition has received less attention. It is, however, accepted that a lessening of competition (whatever the degree) is a relative – as opposed to an absolute – concept, the identification of which requires a comparative judgment that focuses on a possible change along a spectrum of market power.[108] To Illustrate, think of a continuum from perfect competition to absolute monopoly, and then enquire whether the likely effect of proposed conduct is a movement along that continuum that demonstrates a net loss in competition (or a net gain in market power).

184. The practical difficulty is that movements on a theoretical spectrum can, in their smaller (insubstantial) increments, be very difficult to identify. And there is often little return on investment in identifying such movements. The challenge of what amounts to a mere lessening of competition is apparent from the meaning that the Act and the courts have given to the concept of an SLC. Section 2(1A) of the Act defines "substantial" to mean "real or of substance" as opposed to large or weighty. It is therefore arguably already a relatively modest movement along the market power spectrum that can theoretically trigger the SLC threshold. Furthermore, the courts have developed the concept of SLC by describing it as one that is more than nominal or ephemeral.[109] It follows that a mere lessening of competition is to be understood as being purely nominal or ephemeral. Neither of these characteristics is readily ascertainable, and it is accordingly understandable if in some cases it is difficult or even impossible to draw the line between a mere (ie insubstantial) lessening of competition and no lessening of competition at all.[110]

185. For these reasons, the more tangible concept of an SLC remains helpful to the Commission in its threshold enquiry under the authorisation provisions as to whether conduct is likely to lessen competition within the meaning of s 61(6A) so as to necessitate a benefits and detriments analysis. The phrase (substantial) lessening of competition should be interpreted with the aim of the Act in mind – the long term benefit of consumers.[111] Consistent with that aim, an SLC is a lessening of

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108 *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC) at 42.

109 *Commerce Commission v Port Nelson Ltd*, above n 107, at 434.

110 The courts have described the discernment of an SLC as "in the end a question of judgment on a matter of degree" (see *Commerce Commission v Port Nelson Ltd*, above n 107). The Commission considers that this description applies all the more so in regard to identifying a mere lessening of competition versus no lessening at all.

111 In *Radio 2 UE Sydney Pty Ltd v Stereo FM Pty Ltd* (1982) ATPR 40-318 Lockhart J said at p 43,918: "Plainly in the end, it is a matter of judgement as to whether the hindering of competition is of sufficient importance in the context of the policy of the legislation for remedial action to be taken."

competition which creates, enhances or maintains market power, the ability to raise (or, on the buyer side, lower) prices or otherwise act independently of competition.[112] A lessening of competition which does not create, enhance or maintain market power and harm to consumers should not be of concern and accordingly could not be described as "real or of substance".

186. If the Commission considers that a lessening of competition might occur, it will assess whether the conduct would, in all the circumstances, result, or be likely to result, in a benefit to the public which would outweigh the lessening of competition. If the benefits outweigh the lessening of competition, the Commission may grant an authorisation. On the other hand, if the lessening of competition (i.e. detriments) outweighs the benefits, the Commission declines to grant an authorisation.

187. The Commission considers that there are three potential theories of harm in this instance relating to a possible breach of s 27, namely:

187.1 *Monopsony power*: if the Kotahi arrangements created, enhanced or maintained Kotahi's market power, Kotahi could depress prices to below a competitive level.

187.2 *Increased costs for rival exporters*: if Kotahi was able to reduce the price it pays through exerting increased buyer power, the affected ICLs may look to recoup some of the lost profits by increasing the price to other exporters.

187.3 *Foreclosure of customers*: if Kotahi was able to attract a significant number of limited partners and customers on an exclusive basis, other suppliers of ocean freight and related services could be foreclosed as they would have fewer independent customers available to them. Alternatively, customers not in Kotahi might have difficulty obtaining space on ICLs.

188. These theories are discussed in further detail below.

Monopsony power

189. The Commission considers that Kotahi would not have the ability to obtain or the incentive to use monopsony market power. In this respect the Commission concludes that there would be no lessening of competition arising from the Kotahi arrangements.

Theory of harm

190. A potential theory of harm from the creation of a buyer group such as Kotahi is that of monopsony power.[113] That is, if the Kotahi arrangements created, enhanced or maintained Kotahi's market power, Kotahi could depress prices below the competitive level.

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[112] *Gault on Commercial Law* recognises that it is the prevailing view among commentators that market power considerations underlie all threshold tests in the Act. *Gault on Commercial* Law, CA27.13.

[113] Monopsony is the market power-equivalent on the demand side of the market to the monopolist on the supply side. See, for instance, D Carlton and J Perloff *Modern Industrial Organization* (2005), at p 107.

191. The Commission generally views lower prices favourably as lower prices are often to the long-term benefit of consumers. Increases in countervailing power are often associated with reduced prices. When buyers have greater negotiation power, say through the ability to threaten to switch their custom to another supplier, those buyers can often achieve lower prices. Further, countervailing power can often help constrain the exercise of a supplier's market power.[114] Countervailing power can be efficiency enhancing if prices are pushed down closer to 'competitive levels'.

192. In the Commission's view, countervailing power is different to monopsony power.[115] Monopsony power is the exercise of market power by a purchaser by depressing prices below competitive levels.

193. In this instance, if Kotahi had monopsony power it could refuse to pay competitive prices, leading to some freight service providers exiting the market. Exit may include providers leaving the market, but it may also include a reduction in the scope, extent and quality of service.[116] Kotahi would be able to procure freight services at lower prices, although its total quantity of exports would be reduced as there would be insufficient suppliers prepared to carry its goods at such depressed prices. As a result, both freight service outputs and Kotahi's exports would be reduced, with a consequent reduction in society's economic welfare.

The potential for monopsony power to arise in containerised ocean freight

194. Kotahi's ability to obtain and incentive to exercise monopsony power in the factual would depend on:

    194.1 Kotahi's ability to increase its share of the relevant containerised ocean freight markets by gaining new limited partners and customers and increasing the volumes of exports and imports, and in particular high value exported reefer containers that it brings to the negotiating table.

    194.2 The ability of ICLs to supply to other customers.

    194.3 The competitiveness or otherwise of the provision of containerised ocean freight. That is, the extent to which individual ICLs are vulnerable to either a loss of Kotahi's ocean freight demand or Kotahi driving prices down to below competitive levels, such that individual ICLs would exit New Zealand shipping routes thus reducing overall capacity, or reducing the scope and quality of the services they provide.

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114 "The potential for a business to wield market power may be constrained by countervailing power in the hands of customers." Commerce Commission *Mergers and Acquisitions Guidelines* (2004), at p 31.

115 "A key difference is that the exercise of monopsony power results in prices being depressed below competitive levels, whereas the exercise of bargaining power might countervail seller market power and push prices toward competitive levels." OECD *Monopsony and Buyer Power* (2009), at p 9.

116 Throughout this determination "exit" should be understood to include a reduction in the scope, extent or quality of service in addition to an actual "exit" from the market.

194.4 Kotahi's ability to coordinate reduced capacity of services for containerised ocean freight to its limited partners and customers resulting from the potential exit of ICLs.

195. Whether Kotahi has sufficient incentive in this case to exercise monopsony power depends on whether the loss of margin on the volumes of lost export sales is greater or less than the freight cost savings on the remaining volumes of exports.

Kotahi's ability to increase the scale of its operations

196. The Commission considers, for the reasons outlined below, that in the factual Kotahi is likely to procure and manage ocean freight and related services for between 29% and 38% of New Zealand's total containerised ocean freight exports. This compares to between [ ]% and [ ]% in the counterfactual scenario, where Kotahi is likely to manage only Fonterra's containerised ocean freight volumes.

197. In the Commission's view, there would be a relatively small increase in Kotahi's market share between the counterfactual and the factual. This increase would be unlikely on its own to provide Kotahi with monopsony power.

198. As noted earlier, the Kotahi arrangements are in a sense uncertain as Kotahi is still in its infancy. It is difficult for the Commission (and the Applicant) to determine exactly how big (in terms of volume of cargo) Kotahi may get. The Commission has made a judgement as to whom it considers likely limited partners and/or customers of Kotahi may be, based on evidence from its investigation.

199. At a minimum, the factual scenario represents the situation in which Kotahi would procure ocean freight and related services for both Fonterra and SFF, for whom it would handle combined volumes of [ ] TEUs per annum. In addition to Fonterra and SFF, Kotahi is actively courting additional potential limited partners and customers. Kotahi has had discussions with many other potential limited partners or customers since early to mid-2011. However, at the date of this determination, Kotahi [ ].

200. The Commission spoke to a number of exporters and importers about the likelihood of them joining Kotahi.[117] Those interviewed largely consisted of parties identified by Kotahi as firms with which it has had discussions. On that basis, the Commission feels confident that these exporters and importers are the ones which may be likely, at this stage, to become limited partners of Kotahi within the next two years.

201. Generally, exporters and importers expressed some caution about becoming customers and/or limited partners of Kotahi. A large portion of exporters and importers interviewed, by number and volume, are not interested in joining Kotahi. But, a number of exporters and importers are taking a "wait and see" approach before committing either way. Exporters and importers spoken to raised the following reservations:

[117] Attachment C summarises the views of each of the shippers interviewed in terms of joining Kotahi.

201.1 They valued their existing direct relationships with ICLs and direct control of their containerised ocean freight.

201.2 Fonterra would have considerable control over voting and decision making within Kotahi, given its volumes of containerised ocean freight.

201.3 Whether a shipper's confidential customer information would be adequately protected within Kotahi and not be accessible by a competitor.

202. Despite these reservations, some exporters and importers are attracted by the prospect that through Kotahi they may obtain better prices for containerised ocean freight. From the evidence before it, the Commission has identified five other exporters which are considering what Kotahi has to offer. There is more than a remote prospect of these five exporters becoming limited partners or customers of Kotahi within the next two years. The Commission has not identified any importers interested in joining Kotahi.

203. Of course, some of these five parties may not join Kotahi. Others that the Commission have not included may in fact sign up. The analysis below simply forms the Commission's best estimate as to the likely size of Kotahi within the next two years, in order to highlight any potential competition issues arising from Kotahi's aggregation of containerised ocean freight procurement.

204. In the Commission's view, the limited partners and/or customers of Kotahi are likely to comprise those exporters and importers identified in Table 1. Together, these exporters and importers account for approximately 247,000 export TEUs per year. [ ].[118]

Table 1: Exporters and importers likely to form part of Kotahi

Shipper	Estimated TEUs exported per year
Fonterra	[ ]
SFF	[ ]
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]
[ ]	[ ]
Total	**247,000**

118 [ ]

205. Therefore, Kotahi is likely to procure and manage between 29% and 38% of New Zealand's total containerised ocean freight exports. This is based on estimated total containerised export volumes from New Zealand of between 650,000 and 840,000 TEUs per annum, as outlined previously in paragraph 27. The Commission considers this to be the likely foreseeable size of Kotahi because, on the evidence before us, there is more than a remote prospect of the five exporters joining Kotahi.

The ability of ICLs to supply to other customers

206. In the face of an attempted exercise of monopsony power, ICLs may be able to switch their ships to service other non-New Zealand routes. While the Commission defined markets for the procurement of containerised ocean export freight and containerised ocean import freight earlier in this determination, the Commission recognised the potential for ICLs to switch to other countries rather than accept a lower price in New Zealand.

207. There would appear to be ample alternatives for ICLs to service rather than New Zealand. New Zealand accounts for less than 1% of global containerised ocean freight.[119]

208. Kotahi expressed to the Commission its concerns that if it did try to lower prices, without also reducing cost for the ICLs, then ICLs may well stop servicing New Zealand.[120] Of course, as discussed below, returns to ICLs on other routes may not be as attractive as they are in New Zealand. Nevertheless, the Commission considers that as container ships by their very nature are portable, ICLs do in fact have a vast array of potential alternative international customers, which lessens any likelihood that Kotahi could achieve monopsony power.

Whether prices for ocean freight would be at or near competitive levels

209. As ocean freight rates to New Zealand exporters and importers are likely to be above competitive levels in the factual, any ability on the part of Kotahi to depress ICL prices is likely, on average, to be an exercise of countervailing power, rather than an exercise of monopsony power.

210. The Commission has been provided with information from the International Container Lines Committee (ICLC) to suggest that, internationally, ICLs are facing extreme volatility in the balance of supply and demand for containerised ocean freight.[121] [ ] It is not clear, however, that this volatility in freight rates applies to New Zealand containerised ocean export freight.

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119 New Zealand Shippers' Council, August 2010 report titled "The Question of Bigger Ships: Securing New Zealand's International Supply Chain". Referred to as the "Bigger Ships Report".

120 Commerce Commission interview with Kotahi (30 September 2011); Commerce Commission interview with Kotahi (10 November 2011).

121 Commerce Commission interview with ICLC (1 November 2011).

211. Freight rates from New Zealand appear to have decreased by less than elsewhere in the world. Exporters such as [ ] advised that ocean freight rates in New Zealand had declined by about 10% over the last two or three years.[122] Kotahi itself stated that New Zealand export freight rates were not as volatile as global rates generally.[123] The Commission understands that global containerised ocean freight rates have dropped significantly from their peak in 2008.

212. Kotahi and [ ] suggested the following factors contributed to New Zealand freight rates being less volatile than international rates:[124]

212.1 New Zealand exporters contract for longer periods than is common internationally.

212.2 The average size of ships servicing New Zealand waters has doubled in recent years, although they are still significantly smaller than ships servicing the main global trade routes.

212.3 The ICLs are adopting slower steaming policies.

212.4 The global financial crisis has reduced the international demand for ocean freight space resulting in significant overcapacity in global shipping. New Zealand exports volumes have remained more stable.

213. Kotahi submitted that ICLs price on the basis of the value of the cargo in a container consignment.[125] This is termed commodity pricing. While there is a difference in capital and operating costs to the ICLs between dry and reefer containers, within these categories there is no correlation between the ICLs costs and the freight rates they charge. Thus a dry container of export milk powder is charged at a higher rate than a dry container of used paper. Similarly there are scales of freight rates within the reefer category with the Commission having been informed that apples attract the highest rates. This information from Kotahi was generally confirmed by all other exporters that the Commission interviewed.

214. This suggests that ocean freight rates are likely to be above competitive levels and that the ICLs have some degree of market power. ICLs appear to charge on the basis of the value of the commodity being shipped, rather than on the basis of their costs plus a competitively derived margin. Therefore, given that the evidence suggests Kotahi is likely to procure only up to 38% of containerised ocean freight, any ability on the part of Kotahi to depress ICL prices is likely, on average, to amount to an exercise of countervailing power rather than an exercise of monopsony power.

<u>Kotahi's ability to "sell" a reduction in ocean freight capacity to its voting partners</u>

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122 Commerce Commission interview with [ ] (2 November 2011).

123 Commerce Commission interview with Kotahi (30 September 2011).

124 Commerce Commission interview with Kotahi (30 September 2011); Commerce Commission interview with Kotahi (10 November 2011); Commerce Commission interview with [ ] (2 November 2011).

125 Commerce Commission interview with Kotahi (30 September 2011); Commerce Commission interview with Kotahi (10 November 2011).

215. As discussed previously if Kotahi acquired and exercised monopsony power in the factual that would lead to a reduction in capacity by ICLs serving New Zealand ports. The question that arises is whether Kotahi's limited partners would tolerate this reduction in available capacity being allocated to them. In the Commission's view they would not.

216. Without exception, exporters and importers interviewed by the Commission expressed the fear that the downside of the formation of, and increased aggregation of freight volumes in, Kotahi would result in:

    216.1 A reduction in frequency of ICL visits to their port of choice.

    216.2 A reduction in the number of destinations serviced by ICLs from New Zealand ports.

    216.3 An increase in transit times from New Zealand to their destination ports.

217. It does not appear to the Commission that Kotahi's limited partners would agree to a pricing policy that would lead to a reduced allocation of containerised ocean export freight capacity to the limited partners. It appears as though greater net returns to exporters would be generated from increased sales volumes (requiring competitive levels of containerised ocean freight capacity) rather than reduced containerised ocean freight costs on lower export volumes.

218. Moreover, Kotahi would face significant difficulties in coordinating its limited partners to any price reduction as they all face differing incentives. Exporters' needs differ in terms of timeliness of services, frequency, and embarkation and debarkation locations. The impact of ICLs exiting or reducing the quality of their services would variously impact on the different Kotahi limited partners depending on how reliant they are on particular ICLs' services. Therefore, it seems likely that even if Kotahi could gain monopsony power in respect of ICLs, and some of its limited partners had the incentive to exercise it, there is at least some doubt that Kotahi would be able to coordinate all its limited partners to agree.

Potential for monopsony power in port services for containerised ocean freight

219. The Commission has also considered whether Kotahi is likely to gain monopsony power in the market for the procurement of port services for containerised ocean freight. The Commission's view is that Kotahi would neither have the ability nor the incentive to obtain and use monopsony power in this market.

220. Much like the containerised ocean freight market, Kotahi's ability and incentive to obtain and/or exercise monopsony power in the port services market will depend on the following:

    220.1 Kotahi's ability to increase its share of the relevant port services market by gaining new limited partners and customers and increasing its volumes.

    220.2 The extent to which individual ports are vulnerable to either a loss of Kotahi's port services demand or to Kotahi driving prices down to below competitive

levels, such that they might, to some extent, exit the market (either through actual exit or a decrease in the extent, scope and quality of their services or investment).126

220.3 The potential impact on Kotahi's limited partners of reduced port capacity or investment stemming from any exit or reduced services by container ports.

220.4 Kotahi's ability to coordinate reduced capacity of port services amongst its partners, given the differing incentives faced by its partners.

Ports are likely to have some market power

221. Ports are likely to have some degree of market power at present. This means that in some instances prices are likely to be higher than competitive levels. Some export volumes are captive to ports as exporters have no viable alternatives. This may particularly be the case for a port such as Nelson, which is geographically isolated, has no rail link, and has significant export industries located close by. It is also the case for other, better connected ports. [ ]127

222. However, as discussed previously, there are other export production areas that straddle multiple port catchments such that exporters who have competitive alternatives may currently face prices closer to or at competitive levels. If Kotahi successfully reduced intermodal freight costs, it could make greater export volumes contestable across a number of ports.

223. The issue of pricing for port services is complicated by the fact that it is generally ICLs, not exporters, which contract with ports to provide the required services. At first sight it appears that when negotiating with ICLs, ports are unable to discriminate in terms of pricing depending on whose, or what type of, cargo is being carried.

224. However, ports do appear to be able to discriminate between exporters by way of the volume incentives they offer to exporters. Examples of this include:

224.1 [ ]128

224.2 [ ]129

224.3 [ ]130

126 In general "exit of ports" should be understood to mean any retraction of services, including by way of scope or quality.

127 Commerce Commission interview with [ ] (17 October 2011).

128 Commerce Commission interview with [ ] (20 October 2011); Commerce Commission interview with [ ] (17 October 2011).

129 Commerce Commission interview with [ ] (17 October 2011).

130 Commerce Commission interview with [ ] (20 October 2011).

224.4 [ ]131

224.5 [ ]132

225. The fact that ports can price discriminate in a manner that is not based on the ports' costs suggests that the ports are likely to have at least some market power in regard to a number of their customers.

Ports may be reliant on major customers

226. While exporters are dependent on ports, ports are also dependent on local exporters. Unlike the ICLs, ports do not have mobile assets. If Kotahi were able to impose a price decrease on ports, ports do not have the option of switching to serve different catchment areas. They can try to attract freight volumes from a wider area, but their ability to do this is tempered by the economics of intermodal freight services. Moreover, ports may be even more reliant on the volumes of a customer like Kotahi, as such a key customer helps ports attract ICLs to provide services at that port, therefore attracting further exporters and generating more revenue for the ports.

Kotahi's share of relevant product

227. As identified earlier, the Commission's view is that Kotahi's share of the total amount of exports from New Zealand is likely to be between 29% and 38%, compared to Kotahi having a [ ]% to [ ]% market share in the counterfactual. In the Commission's view, this relatively small increase in Kotahi's market share would be unlikely on its own to provide Kotahi with much, or any additional buying power in regard to the ports.

228. The Commission recognises that Kotahi could have a larger proportion of exports at a particular port or region than it would nationally. Given the uncertainty as to which exporters may eventually join Kotahi, it is difficult to accurately estimate regional variations. Nevertheless, the Commission has spoken to major exporters in each region who have advised that they are very unlikely to join Kotahi in the future. Therefore, at this time, the Commission considers that there is insufficient evidence to suggest that Kotahi's share of exports would be significantly higher for any particular port or region.

Risk to Kotahi's partners

229. If Kotahi was able to attain monopsony power, it is unlikely that its limited partners would have the incentive to exercise that monopsony power. For monopsony power to be exercised, some ports would need to exit the market, leading to reduced service quality or quantity. Additionally, the exercise of monopsony power could lead

131 Commerce Commission interview with [ ] (12 October 2011).
132 Commerce Commission interview with [ ] (14 October 2011).

to reduced port investment if ports are unsure as to whether they would be able to recoup their costs of capital required for investment.

230. Kotahi's limited partners would be vulnerable to ports exiting or to ports not investing in improving productivity and infrastructure. The cost of port services is only a small proportion of total ocean freight costs, which in turn is only a small proportion of the total costs to export a container. The gains from lower port costs would seem insufficient to compensate exporters for reduced port capacity and the likelihood of reduced port investment, leading to lower port and shipping efficiency in the future. That is, exercising such monopsony power could risk undermining the ability of exporters to viably get their products to market.[133]

Difficulty in coordinating

231. As with the containerised ocean freight markets above, the Commission notes that even if Kotahi did have the incentive to exercise monopsony power, Kotahi would face significant difficulties in coordinating its limited partners to agree, as they all face differing incentives. For example, some Kotahi limited partners may be more seriously impacted by a port's exit, perhaps if that port is their local port or if the majority of their production is located within its catchment area. Other exporters, whose production may straddle multiple port catchment areas may be less affected in terms of the reduced services from a port, as they have other options, but they may equally benefit from any reduced prices that could be achieved through exercising monopsony power. Therefore, even if Kotahi gained monopsony power and some of its limited partners had the incentive to exercise it, there is at least some doubt that Kotahi would be able to coordinate all its limited partners to agree.

Increased costs for rival exporters

232. The Commission considers that any increased costs to rival exporters stemming from Kotahi's activities are unlikely to be as a result of Kotahi exerting market power against any particular person or class of persons.

233. This theory of harm posits that if a buyer group is able to reduce the price it pays through exerting increased buyer power, the effected sellers may look to recoup some of the lost profits by increasing the price to other purchases. This theory is often referred to as 'the waterbed effect'.

234. Under this theory, even absent monopsony power, Kotahi would have the ability to negotiate favourable freight rate prices for itself through the use of its greater bargaining power (without any reduction in output). It is assumed that the freight providers would then attempt to overcome their lost revenue from Kotahi's limited

[133] The Commission notes that Kotahi would be ambivalent as to whether ports that it efficiently would not use exited the market. That is, it is conceivable that some ports may exit or reduce the services they provide in the future due to the normal business decisions that exporters make based on which port it is rational for them to export from. Exit from the market by these ports may disproportionally affect other exporters more. However, as discussed in greater detail earlier in relation to the containerised ocean freight markets, the Commission does not consider this to be a lessening of competition, rather it is a natural consequence of normal business decision-making, and is unlikely to be different from the situation in the counterfactual, to any great extent.

partners by raising the prices or reducing the service they provide to non-Kotahi exporters who have less bargaining power.

235. However, if freight providers could charge higher prices to other exporters, as profit maximising enterprises they would already seek to do so. For freight service providers to increase prices further, Kotahi would have to lead to some additional change that would facilitate higher prices from exporters and importers. Conceivably this could occur if:

235.1 ICLs not used by Kotahi become less efficient due to reduced or more volatile demand, and those higher costs are passed on to non-Kotahi exporters.

235.2 Kotahi's lower freight costs allow its limited partners to capture a greater share of upstream markets (such as the acquisition of dairy farmers' raw milk), consequently decreasing the upstream market shares of rivals, further decreasing those rival exporters and importers bargaining power with freight service providers.

235.3 Kotahi's increased bargaining power leads to ICLs increasing their services to Kotahi's preferred ports, with a consequent reduction in the number of services to other ports. Non-Kotahi exporters not located near the preferred ports may have fewer shipping services or a reduction in the quality of those services and so may incur greater intermodal freight costs to get goods to a viable export port.

236. It is unclear whether so-called 'waterbed effects' can be taken account of in this authorisation setting. As discussed above, the Commission considers that, for there to be a lessening of competition in respect of s 27 of the Act, Kotahi needs to create, facilitate or enhance market power. To that end, increased costs to rivals in this instance appear to arise from the normal course of Kotahi seeking to maximise its own efficiencies, rather than from Kotahi exerting market power against any particular person or class of persons.

Foreclosure of customers

237. The Commission considers Kotahi is unlikely to foreclose its rivals from competing for customers to the extent that a lessening of competition would likely occur.

238. The Applicant submitted a potential theory of harm which is that if Kotahi was successful in signing up a sizeable volume of limited partners and customers on an exclusive basis, other suppliers of ocean freight and related services would have a much smaller pool of independent customers available to them and may be foreclosed from competing in the market and/or customers not in Kotahi might have difficulty obtaining space on ICLs.[134]

239. This situation could result in a lessening of competition as s 3(5) of the Act allows for the aggregation of a number of individual contracts. The Applicant submitted that

[134] Application, at para 5.18.

with only its current limited partners (Fonterra and SFF), Kotahi would have exclusive responsibility for procuring [ ]% of the services for containerised ocean export freight. If further limited partners (or customers who commit to Kotahi on an exclusive basis) sign up to Kotahi, then they may push the 'foreclosed volumes' so high that it leads to an SLC.[135]

240. Kotahi will continue to procure services for containerised ocean freight from ICLs. It will not compete with ICLs in the provision of the physical carriage of those goods. Therefore, there will be no reduction of freight volumes available for ICLs to carry.

241. There is nothing in the Kotahi arrangements that stipulates from whom Kotahi would procure its services for containerised ocean freight. Nor do the Kotahi arrangements detail the terms of any such purchases, such as exclusivity or length of contract. Kotahi has advised it is likely to procure services from a range of ICLs.[136]

242. Kotahi could theoretically foreclose freight forwarders or other related freight management service providers from the market, however the Commission considers this is unlikely as Kotahi is unlikely to change significantly in size between the factual and counterfactual. It will therefore be unlikely to have the sufficient size to lead to the foreclosure of a competitor.

243. In addition, freight forwarders or other providers of management services for containerised ocean freight may continue to compete with Kotahi to provide such services to (a) exporters and importers outside of the Kotahi arrangements, (b) to exporters and importers who are customers of Kotahi[137], or (c) to limited partners of Kotahi either prior to those limited partners entering into a Services Agreement with Kotahi or by persuading limited partners to exercise their option to exit the partnership.

244. Moreover, the Commission considers that even in the unlikely scenario that there was a foreclosure effect in respect of exporters, those exporters denied access to Kotahi-tied ships could entice other ships to New Zealand as ICLs have the ability to increase their capacity servicing New Zealand.

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135 Ibid.

136 Commerce Commission interview with Kotahi (30 September 2011).

137 Customers of Kotahi do not have to exclusively commit to procure all of their ocean freight service requirements from Kotahi.

Determination

245. The Commission is not satisfied that the Kotahi arrangements contain an exclusionary provision under s 61(7) of the Act. Having found no exclusionary provision, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(5) and (6) of the Act.

246. The Commission is not satisfied that the Kotahi arrangements will result, or be likely to result, in a lessening of competition under ss 61(6) and (6A) of the Act. Having found no likely lessening of competition or deemed lessening of competition, the Commission declines the application for authorisation of the Kotahi arrangements under ss 58(1) and (2) of the Act.

Dated this 15th day of March 2012

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Dr M N Berry

Chair

Attachment A: Volumes of containerised ocean freight

A1. The size of the containerised ocean freight market is important for understanding Kotahi's likely size and scale, and whether any lessening of competition is likely to result from Kotahi. However, the Commission has experienced some difficulties in getting accurate information on New Zealand's volumes of containerised ocean freight. The data that is available from Statistics New Zealand on export volumes is in tonnes. Whilst the data is broken down into specific ports, there is no breakdown of the data that reveals the portions of the volumes that are containerised ocean freight versus bulk or non-containerised cargo.

A2. The port companies collect and share containerised ocean freight volumes amongst themselves. For the year ended 30 June 2011, this data records that New Zealand ports handled a total of 2.4 million TEUs. However, almost 380,000 TEUs related to transhipments around the country. In addition, approximately 640,000 TEUs was the import and export of empty containers. Removing these volumes leaves total full container exports and imports of around 1.46 million TEUs. The port company data records 58% (approximately 840,000 TEUs) of this volume to be exports and 42% (approximately 620,000 TEUs) to be imports.

A3. The New Zealand Shippers' Council, in the Bigger Ships Report, has separately conducted analysis to estimate in TEUs of containerised ocean freight volumes (in terms of full containers only). The Applicant has referred to this data in its application for authorisation. The Shippers' Council analysis, using 2008 volume data sourced from Statistics New Zealand, estimated containerised exports to be approximately 624,000 TEUs and imports to be approximately 507,500 TEUs. These figures are lower than those in the port company data, even if allowance is made for export growth between 2008 and 2011 (as the Shippers' Council is based on older data).

A4. The Commission has tested the size of the containerised ocean freight market with a number of industry participants. Most have estimated full containerised exports to be between 600,000 and 650,000 TEUs per annum. However, the ICLC has estimated exports to be slightly higher at 650,000 to 700,000 TEUs.[138] Exports in the range of 600,000 to 700,000 TEUs (with a midpoint of 650,000) are materially lower than the 840,000 TEUs figure provided by port companies. In this determination, without certainty as to actual volumes, the Commission uses both 650,000 and 840,000 TEUs as estimates to provide a range of New Zealand's containerised exports. The 650,000 being the most conservative figure.

[138] Commerce Commission interview with ICLC (1 November 2011).

Attachment B: The arrangements and legal structure

B1. Kotahi has been established as a limited partnership. Limited partnerships are a form of partnership involving general partners and limited partners. General partners are responsible for the management of the limited partnership and are liable for all the debts and liabilities of the partnership, if such debts cannot be met by the limited partnership. Limited partners are liable only to the extent of their capital contribution to the partnership. In the case of Kotahi, the general partner is Kotahi GP.

B2. Currently, Fonterra is the sole limited partner of Kotahi and sole shareholder of the Kotahi GP. This interim arrangement has been established on the terms set out in a Limited Partnership Agreement dated 27 May 2011.[139] The agreement is between Kotahi GP, Fonterra (the initial limited partner) and Kotahi. The Applicant submitted that the agreement is in a basic form and does not contain any provisions specific to the proposed operation of the limited partnership once SFF has joined.

B3. Fonterra and SFF have entered into a separate Establishment Agreement.[140] This agreement sets out the terms on which Fonterra and SFF agree to establish Kotahi. The terms include:

B3.1 Seeking authorisation from the Commission prior to fully implementing the limited partnership.

B3.2 Kotahi conducting negotiations with ICLs in respect of the procurement of containerised ocean freight. These negotiations to be conducted on the basis that SFF's export volumes would also be part of Kotahi from [ ].

B4. The Establishment Agreement provides that at [ ], regardless of whether the Commission has given or declined authorisation, Fonterra and SFF would execute a LPA and adopt the Constitution of Kotahi GP (Constitution).[141] These documents provide detail on the governance arrangements for Kotahi and how the limited partnership would operate. The LPA includes details as to how other exporters and importers can become limited partners or customers of Kotahi, and also how limited partners are able to exit. Further detail on these matters is provided on subsequent pages.

B5. In addition to the agreements already noted, there is also a Services Agreement. Fonterra has already signed such an agreement with Kotahi. If the Commission grants authorisation, SFF proposes to sign a Services Agreement with Kotahi.[142] This agreement covers the provision of both ocean and landside services by Kotahi. The

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139 This agreement is included in schedule 4 to the application.

140 This agreement is included in schedule 1 to the application.

141 The proposed form of Limited Partnership Agreement is included in schedule 2 to the application. The proposed Constitution of Kotahi GP Limited is included in schedule 3 to the application.

142 The proposed form of the Services Agreement between Kotahi and SFF is included in schedule 5 to the application. The Establishment Agreement notes that the Services Agreement between Fonterra and Kotahi is substantially on the same terms as the agreement included in schedule 5.

Establishment Agreement provides that absent authorisation, SFF would sign a Restricted Services Agreement. It states that the Restricted Services Agreement would be in the same form as the proposed Services Agreement, with such amendments as necessary to comply with law.

B6. Under clause 25.1 of the proposed Services Agreement, all product managed by Kotahi under the Services Agreement on behalf of SFF remains the property of SFF (or SFF's customers or product suppliers as applicable) at all times and at no time would title in the product pass to Kotahi.

Governance arrangements regarding Kotahi

B7. The LPA sets out provisions in respect of voting rights, allocation of shares, capital contributions, advances, allocations and distributions. Generally, each is on a pro rata basis between the limited partners of Kotahi, in proportion to their respective "cargo percentage". The cargo percentage of a limited partner is proposed to be calculated as follows:

$$\frac{\text{Committed cargo of a limited partner}}{\text{Total committed cargo of all limited partners}}$$

B8. The LPA defines "committed cargo" as the volume of ocean freight cargo managed by Kotahi on behalf of a limited partner.

B9. Clause 12.1(d)(ii) of the LPA provides that the quorum for a meeting of Kotahi Limited partners is 75% of voting rights, including Fonterra and at least 30% of the remaining (non-Fonterra) voting rights. Unless a special resolution is required by the LPA or applicable law, all voting amongst limited partners is by way of ordinary resolution. To be passed, an ordinary resolution requires the approval of limited partners holding more than 50% of voting rights. A special resolution requires the approval of limited partners holding at least 75% of voting rights, including Fonterra and at least 30% of the remaining voting rights.

B10. The provisions of the LPA mean that no resolution can ever be passed that Fonterra disagrees with. Initially, SFF (as the only other limited partner) would also need to agree with any resolution. However, as other exporters and importers become limited partners, not all would need to agree with a resolution for it to be passed.

Governance arrangements regarding Kotahi GP

B11. The Constitution sets out provisions in respect of the governance of the general partner, Kotahi GP. Every limited partner would each hold only 1 share in Kotahi GP. However, shareholder voting rights and distributions would, as with the limited partner (Kotahi), be on a pro rata basis between the limited partners of Kotahi, in proportion to their respective "cargo percentage". The percentages of shareholder voting rights required for a meeting quorum, and to pass ordinary and special resolutions, are the same as for meetings of the limited partners of Kotahi.

B12. The Constitution provides that the number of directors of Kotahi GP "will be no less than three". Clause 34.4 of the Constitution gives Fonterra the ability to appoint two

directors. Clause 34.2 provides that other limited partners "will be entitled from time to time" to appoint one director. It is not clear from this clause and the use of the words "from time to time" whether each of the other limited partners can always have appointed one director or whether, at any one time, only some of the other limited partners would have appointed a director.

B13. As with limited partner and shareholder meetings, voting at Kotahi GP board meetings is on a pro rata basis, in proportion to "cargo percentage". The voting rights held by a director are equivalent to the voting rights held by the shareholder who appointed that director. In the case of Fonterra, its two directors together or on their own (if only one is present) hold Fonterra's voting rights.

B14. Schedule 2, clause 7 of the Constitution provides that the quorum for a board meeting of Kotahi GP is the directors that represent 75% of voting rights. This is specifically required to comprise one Fonterra appointed director along with those directors that together hold 30% of the remaining voting rights.

B15. Unless an extraordinary directors' resolution is required, all resolutions are passed by the board if supported by directors holding a majority of voting rights. To be passed, an extraordinary director's resolution requires the approval of directors holding at least 75% of voting rights, including Fonterra and at least 30% of the remaining voting rights. This is consistent with the voting for special resolutions of limited partners and shareholders.

B16. Clauses 43 and 44 of the Constitution set out the decisions that require a special resolution of shareholders or an extraordinary director's resolution. This includes:

B16.1 Under clause 44(f), "any material alteration to the business of Kotahi".

B16.2 Under clause 43.2, any transaction that might mean Kotahi incurs obligations or liabilities of $250,000 or more.

Requirements to become a limited partner

B17. The LPA provides that new limited partners of Kotahi must be approved by special resolution. The Applicant submitted that this may give Fonterra and SFF some opportunity to control who becomes a limited partner. However, clause 4.4(a) of the LPA provides that an existing limited partner can only refuse to give its approval to a new partner where "it has a bona fide commercial objection". The LPA is silent as to what constitutes such an objection. This aside, the Applicant submitted that both Fonterra and SFF "will be looking to grow the limited partnership in order to achieve the level of scale required to realise the potential benefits and are therefore unlikely to withhold their approval".

B18. To become a limited partner of Kotahi, a shipper has to (under clause 4.4(b) of the LPA and clause 12 of the Services Agreement) "exclusively commit to procure all of its ocean freight services requirements" from Kotahi by entering into a Services Agreement (the Exclusivity Requirement). A new limited partner also has to:

B18.1 Execute a Deed of Adherence under which it agrees to the terms of the LPA.

B18.2 Contribute capital to Kotahi.

B18.3 Purchase 1 share in Kotahi GP Limited at the subscription price of $0.01.

B18.4 Sign a Loan Agreement with Kotahi and agree to lend (advance) it money. Any new limited partner has to pay a portion of this "limited partner advance" to Kotahi before becoming a partner. Kotahi may drawdown the remainder of the loan in the future.

B19. Clause 3.7 of the LPA provides for limits on the aggregate capital contributions and advances of all limited partners. As already noted, contributions and advances are done on a pro rata basis between the limited partners of Kotahi, in proportion to their respective cargo percentage. The effect of these provisions is that as other exporters and importers become limited partners, pre-existing limited partners may get some capital or advances returned.

How limited partners can exit

B20. Clause 8.3 of the LPA gives a limited partner the option to exit Kotahi and cease to be a limited partner. No reason is needed to be provided for a limited partner to exit. However, a limited partner is only able to exit one day a year, at Kotahi's balance date (which is 31 July). In order to exit, the LPA and clause 23.2 of the Services Agreement require that the limited partner gives notice at least 6 months prior to 31 July.

B21. The Applicant submitted that, where this ability to terminate is exercised, a limited partner would be free to contract directly with other suppliers of ocean freight services after it has exited.[143] The requirement that a limited partner "exclusively commit to procure all of its ocean freight services requirements" from Kotahi means that it is not able to contract with anyone else before then.

Requirements to become a customer

B22. If a shipper does not (for whatever reason) want to become a limited partner of Kotahi, it can instead seek to become a customer of Kotahi. There are fewer requirements to become a customer than a limited partner. A customer simply needs to sign a Services Agreement with Kotahi.

B23. The Applicant submitted that customers "will not be required to commit exclusively to the services of Kotahi Logistics".[144] For customers, exclusivity would be optional. Kotahi has indicated to the Commission that customers may get discounts (better pricing) if they commit exclusively.

B24. There is no express provision dealing with the approval of additional customers contained in the LPA or Constitution. However, the Applicant submitted that, given

[143] Application, at para 5.18.
[144] Ibid, at para 8.4.

the Constitution, "it is likely that any services agreement between Kotahi Logistics and a potential customer will require both an extraordinary director's resolution and a special resolution of shareholders". Kotahi has indicated to the Commission that any shipper could become a customer, subject to their demand profile fitting comfortably.

Pricing mechanism

B25. Under clause 3 of the Establishment Agreement, Kotahi would negotiate ocean freight rates on behalf of its limited partners and customers who, absent the provision, are competitors for the acquisition of ocean freight services. Clause 2.4 of the Services Agreement states that Kotahi would endeavour to negotiate "the most favourable commercial terms reasonably available".

B26. The Applicant submitted that the objective of Kotahi "is to lower the cost/price bar for all customers not to create a common rate" for ocean freight or landside transport.[145] Kotahi does not propose to have standardised pricing for all its exporters and importers. Instead, it would negotiate pricing directly with ICLs and other freight suppliers in respect of each limited partner's or other customer's cargo.

B27. Kotahi plans to charge its limited partners and other customers an overall fee comprising transaction costs and sea freight charges based on an agreed pricing mechanism. This Pricing Mechanism is set out in clause 4.8 of the LPA and referred to in clause 17.1 of the Services Agreement. Clause 4.8 provides that:

> …pricing to Limited Partners and customers of the Limited Partnership (*Customers*) will reflect [ ] and it is intended that [ ] in the pricing received by the Limited Partners and Customers under their respective services agreements with the Limited Partnership.

B28. The Applicant submitted that clause 4.8 is effectively an agreement between Fonterra and SFF "as to how price will be calculated both for each other and any additional limited partner or third party customer".[146]

[145] Ibid, at paras 17.8 and 18.10.
[146] Ibid, at para 5.18.

Attachment C: Extent of interest in joining Kotahi

C1. Table 2 summarises the views of each of the exporters and importers interviewed in terms of joining Kotahi. The exporters and importers are grouped in the table according to their level of interest.

Table 2: Exporters and importers interest in Kotahi

Level of interest	Interest in Kotahi
Currently seriously considering joining	• [ ] • [ ]
Had discussions with Kotahi and may consider joining in the future	• [ ] • [ ] • [ ]
Had discussions with Kotahi but rejected joining	• [ ] • [ ]
Had no discussions with Kotahi, but could possibly be interested	• [ ] • [ ]

Level of interest	Interest in Kotahi
Had no discussions with Kotahi and are unlikely to be interested	• [ ] • [ ] • [ ] • [ ] • [ ] • [ ]
Had discussions with Kotahi, but are not that likely to be interested	• [ ]