

Commerce Commission

Decision No. 324

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

MAINLAND PRODUCTS LIMITED

and

SOUTH ISLAND DAIRY FARMERS CO-OPERATIVE LIMITED

The Commission: T G Stapleton
K M Brown
R N Taylor

Commission Staff: John Preston
Jane Chilcott
Juliet Fletcher

Summary of Proposed Acquisition: The acquisition by Mainland Products Limited, or any of its interconnected bodies corporate, of the fresh milk and cream, and yoghurt and other cultured dairy food assets of South Island Dairy Farmers Co-operative Limited.

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

Date of Determination: 12 May 1998

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THE PROPOSAL

- 1 On 21 April 1998, the Commission registered a notice pursuant to s 66(1) of the Commerce Act 1986 (“the Act”) seeking clearance for the acquisition by Mainland Products Limited (“Mainland”), or any of its interconnected bodies corporate, of the fresh milk and cream, and yoghurt and other cultured dairy food assets of South Island Dairy Farmers Co-operative Limited (“SIDF”).
- 2 The acquisition is to be implemented by Kiwi Co-operative Dairies Ltd (“Kiwi”), through its South Island subsidiary Kiwi South Island Co-operative Dairies Ltd, acquiring all of SIDF’s business and immediately selling the non bulk consumer products side of the business to Mainland. This will leave SIDF’s milk supply contracts, milk powder plant, New Zealand Dairy Board shares and 15% interest in the Otago Cheese Company Ltd with Kiwi. The assets to be acquired by Mainland are set out in Appendix 1 to this decision and comprise the local and export consumer products business of SIDF. SIDF’s co-operative members will become members of the Kiwi Co-operative.
- 3 Mainland and Kiwi are considered to be interconnected bodies corporate as defined by s 2(7) of the Act (Mainland is 83% owned by Kiwi). The application for clearance relates only to the assets of SIDF to be acquired by Mainland. Because of the close relationship between Mainland and Kiwi, Commission staff will also assess the likely effects of the proposal in relation to the assets to be acquired and retained by Kiwi. However, any clearance applies only to the assets of SIDF to be acquired by Mainland and not to any such assets to be acquired and retained by Kiwi.
- 4 The proposal is subject to shareholder approval, and if approved, is likely to be completed by 31 May 1998.

THE PROCEDURES

- 5 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. As the applicant has agreed to an extension of 6 working days, a determination is required by 13 May 1998.
- 6 Mainland sought confidentiality for certain information contained in the notice seeking clearance, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act will apply to that information.
- 7 This report concludes that Commission staff are satisfied that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market. Accordingly, it is recommended that in terms of s 66(3)(a) of the Act, the Commission gives clearance for the proposed acquisition.

THE INVESTIGATION

- 8 Staff contacted the following parties in investigating the proposed acquisition:
- Other dairy co-operatives including Kaikoura Co-op Dairy Co Ltd, Westland Co-op Dairy Co Ltd, Tasman Milk Products Ltd, NZ Co-operative Dairy Company Ltd
 - Southern Fresh Milk Co Ltd, Nelson Milk Ltd, International Fine Foods Ltd
 - Federated Farmers of NZ (Inc)
 - The New Zealand Dairy Board
 - National Association of Milk Vendors

- Supermarket groups including Woolworths NZ Ltd (“Woolworths”), Progressive Enterprises Ltd (“Progressive Enterprises”), Foodstuffs (South Island) Ltd (“Foodstuffs”)
- Oil companies including BP Oil New Zealand Ltd (“BP”) and Shell New Zealand Ltd (“Shell”).

9 Additional information was also provided by the applicant.

THE PARTICIPANTS

Mainland Products Ltd (“Mainland”)

- 10 Mainland is a private company owned 83% by Kiwi and 17% by Aorangi Laboratories Ltd. Kiwi is the second largest dairy co-operative in New Zealand, with about 4,000 suppliers. The majority of these suppliers are located in Taranaki, Manawatu and Hawke’s Bay. Aorangi Laboratories has no other involvement in the dairy industry.
- 11 Mainland’s business activities include the acquisition of unprocessed milk for manufacture into fresh milk, cream, yoghurt and other cultured milk products and specialty cheeses (sold under the “Tararua” and “Ski” brands); the packing, wholesaling and marketing of certain dairy products for the domestic market; the manufacture and packaging of specialty cheeses for export; the wholesaling of processed meats under the “Frasers” brand; and other small undertakings related to the chilled foods industry.
- 12 The major brands owned and used by Mainland are “Mainland”, “Valumetric”, “Galaxy”, “Ferndale”, “Tararua” and “Ski”. Implementation of the proposal would make Mainland the largest supplier of chilled food products in New Zealand.

South Island Dairy Farmers Co-operative Ltd (“SIDF”)

- 13 SIDF is a Christchurch based dairy co-operative company, involved in the purchase of unprocessed milk from its 180 supplying shareholders, and the processing and distribution of fresh milk and cream under the “Meadow Fresh” brand. The company is also involved in the manufacture and sale of UHT (ultra heat treated) milk, yoghurt and other cultured dairy foods (primarily in the South Island), fruit juices and the conversion of milk into milk powder for export. SIDF has processing facilities in Christchurch and Dunedin, and owns a 50% share in the Balclutha Milk Station Ltd.

OTHER RELEVANT PARTIES

New Zealand Co-operative Dairy Company Ltd (“NZCDC”)

- 14 NZCDC, based in the Waikato, is the largest dairy co-operative in New Zealand with approximately 6,000 suppliers. Its subsidiaries include Anchor Products Ltd, Anchor Equities Ltd, New Zealand Dairy Foods Ltd (“NZ Dairy”), Glencoal Energy Ltd and Anchor Investments Ltd.
- 15 The principal activities of NZCDC and its subsidiaries include the collection and processing of its suppliers’ milk into dairy based products for domestic and export markets; marketing and distribution of branded dairy based consumer products primarily in New Zealand; dairy related support activities including rural retailing, food ingredients marketing and packaging; and the provision of energy to the processing factories. NZCDC uses the “Anchor” brand for some of its products such as milk, butter and cheese.

Nelson Milk Company Ltd (“Nelson Milk”)

- 16 Nelson Milk is a town milk processor, and has a franchise agreement with NZCDC in relation to the “Anchor” brand for the Marlborough, Nelson and West Coast regions. Nelson Milk also produces and supplies milk under the “Sun City” brand. The company distributes town milk in Nelson, down the West Coast, and in Blenheim and Marlborough.

Southern Fresh Milk Company Ltd (“Southern Fresh”)

- 17 Southern Fresh, based in Invercargill, is involved in the production and supply of town milk under both the “Anchor” brand and the company’s own brand “So Fresh”. Southern Fresh supplies town milk from Invercargill to North Canterbury, and holds the “Anchor” franchise for Southland, Otago and Canterbury. Neither Nelson Milk nor Southern Fresh is involved in the processing of other dairy products.

Other South Island Dairy Co-operatives

- 18 There are 11 co-operative dairy companies in New Zealand. Other dairy co-operatives operating in the South Island include Alpine Dairy Products Ltd, Kaikoura Co-op Dairy Co Ltd, Marlborough Cheese Co-op Ltd, Tasman Milk Products Ltd, Westland Co-op Dairy Co Ltd and Southland Dairy Co-operative Ltd¹. Kiwi also operates in the South Island through its subsidiary Kiwi South Island Co-operative Dairies Ltd.

¹Alpine Dairy Products Ltd and Southland Dairy Co-operative Ltd have recently announced that they propose to merge. An application under s 66 of the Commerce Act has not been made, however the Commission is concurrently investigating this proposal.

BACKGROUND INFORMATION

- 19 The Commission has assessed a number of previous business acquisition proposals involving dairy companies, principally in the North Island. The more recent reports include:
- Kiwi Co-operative Dairies Ltd/Tui Milk Products Ltd²
 - New Zealand Co-operative Dairy Company Ltd/East Tamaki Co-operative Dairy Company Ltd³
 - New Zealand Co-operative Dairy Company Ltd/Bay Milk Products Ltd⁴
 - Mainland Products Ltd/Kiwi Co-operative Dairies Ltd⁵
 - South Island Dairy Farmers Ltd/Westport United Dairies Ltd⁶
 - South Island Dairy Farmers Ltd/Grey District Co-operative Milk Producers Association Ltd and Scenicland Milk & Cream Ltd⁷.
- 20 Some of these reports (*Kiwi/Tui and NZCDC/East Tamaki*) contain extensive detail on the structure and development of the New Zealand dairy industry. It is not intended to repeat this information in this report.
- 21 The market for the processing and wholesale supply of town milk has changed substantially in terms of the range of products offered, and distribution channels. Increasingly, the glass bottle has been replaced by cardboard cartons and plastic bottles. Supermarkets are becoming major retailers, taking increasingly larger market shares from other retailers. Convenience stores operated by oil companies are also increasing their market shares at the expense of traditional corner stores and home deliveries.

²M2305, 15 August 1996.

³M2311, 2 September 1996.

⁴M2316, 27 September 1996.

⁵M2318, 15 October 1996.

⁶Decision 300, 3 July 1997.

⁷Decision 301, 3 July 1997.

- 22 It was noted in the Commission's two most recent decisions relating to the dairy industry⁸ that the South Island dairy industry is characterised by a co-operative structure, like that of the North Island. All companies are owned by their milk supplying shareholders. Substantial rationalisation within the industry has occurred over recent years, predominantly in the North Island.
- 23 Commission staff have also previously noted that further changes to the existing structure of the South Island dairy industry are expected over the next few years. Further mergers and rationalisation are considered likely by many involved in the industry.
- 24 The trend towards dairying from sheep and beef farming is continuing in New Zealand, although the rate of growth of the dairy farming industry has slowed down. Over the last 5 years, on average, milk output has been expanding annually at 4.5%⁹, and processing facilities have expanded accordingly.

THE RELEVANT MARKETS

Introduction

- 25 The purpose of defining markets is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act in any of those markets.
- 26 Section 3(1A) of the Act provides that:

⁸ n.6 and n.7.

⁹ Situation and Outlook for New Zealand Agriculture 1997 (Ministry of Agriculture).

... the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.

27 In a 1984 decision, the Commission, drawing upon the Australian Trade Practices Tribunal decision in *Queensland Co-operative Milling Association*,¹⁰ defined a market as:

... a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.¹¹

28 Markets are defined in relation to product type, geographical extent, and functional level. With the first two dimensions, market boundaries are determined by testing for substitutability, in terms of the response to a change in relative prices of the good or service in question and possible substitute goods or services. A properly defined market will include products which are regarded by buyers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension), and are thus products to which they could switch if a small yet significant and *non-transitory increase in price (ssnip)* of the product in question was to occur. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, even though they do not do so currently.

29 In addition, markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of functional levels. For example, that between manufacturers and wholesalers might be called the “manufacturing market”, while that between wholesalers and retailers is usually known as the “wholesaling market”.

¹⁰ *Queensland Co-operative Milling Association*, (1976) ATPR 40-012 at 17,247.

¹¹ *Edmonds Food Industries/WF Tucker & Co Limited*, Decision No. 84, 21 June 1984.

Market Definition

- 30 The applicant submits that the proposed acquisition will result in aggregation of market share in the market for the processing and wholesale supply of town milk; the market for the manufacture and supply of yoghurt and other cultured dairy foods; and the market for the acquisition of unprocessed milk.
- 31 As indicated above, although the application relates only to the assets of SIDF to be acquired by Mainland, the likely effects of Kiwi's acquisition of certain assets of SIDF will also be assessed. Kiwi intends to acquire and retain the following assets of SIDF:
- 15% of the equity in the Otago Cheese Company Ltd at Stirling;
 - SIDF's shares in the New Zealand Dairy Board ("the NZDB");
 - all farmer supply contracts, farm milk vats and tankers relating to the supply and collection of unprocessed milk from SIDF's 180 suppliers;
 - all of the relevant plant at SIDF's Blenheim Road site which is used for the production of milk powders (predominantly for export).
- 32 In relation to the first two assets listed above, Kiwi already owns 85% of the Otago Cheese Company Ltd as a result of its merger with the Otago Co-operative Dairy Co Ltd. The factory manufactures bulk cheese, primarily for the export market via the NZDB. The acquisition by Kiwi of the remaining 15% will have no effect on the volume of cheese manufactured. Shares in the NZDB are based on proportional shares of sales of milk solids to export markets via the NZDB. The combined shareholding of Kiwi/SIDF in the NZDB would be less than 28% post acquisition. Commission staff conclude that there are no dominance issues in respect of the acquisition of such assets by Kiwi.
- 33 It is acknowledged by the applicant that there will be aggregation of market share in the market for the acquisition/supply of unprocessed milk as a result of the proposed acquisition. In addition, Commission staff consider that there will be

aggregation in the market for the processing and supply of powdered milk products to the domestic market. Kiwi's acquisition of the other two assets listed in paragraph 31 above will be considered in relation to those markets later in this report.

- 34 Previous reports relating to business acquisitions in the dairy industry have examined the issue of market definition. In the report relating to the *Kiwi/Tui* proposal, the markets identified and analysed were the markets for the acquisition/supply of unprocessed milk in the greater part of the North Island, and the processing and wholesale delivery of town milk in the greater part of the North Island. Commission staff have examined these markets further in later business acquisition proposals.
- 35 As discussed further below, the relevant product and functional markets for the proposed acquisition (those assets to be acquired by Mainland) are considered to be those for the acquisition/supply of unprocessed milk, and the processing and wholesale supply of town milk. The markets for the manufacture and wholesale supply of yoghurt and other cultured dairy foods, and the processing and supply of powdered milk products are also relevant.

Product Type

- 36 Milk sold in New Zealand is referred to as "town milk". In the past, town milk has been produced from supplies of milk from different farmers to those who supply dairy factories. However, in recent years, some companies which have interests in both town milk and manufacturing dairy products have ceased drawing milk from separate sources, but offer a winter premium for town milk supplies to reflect the additional input costs in producing out of season milk.
- 37 The applicant argues that UHT milk and ESL (extra shelf life) milk taste increasingly like fresh milk, and are now being widely used in Europe, Latin

America, Australia, Canada and the US as substitutes for fresh milk. The issue of substitutability of UHT milk for fresh milk was examined by the Commission in a previous decision, *New Zealand Co-operative Dairy Co Ltd/Waikato Valley Dairies Ltd*¹².

- 38 In that decision, the Commission noted that UHT milk sales in New Zealand were very small in comparison to those of fresh milk, and that UHT milk is priced substantially higher than fresh milk. It was acknowledged that the product occupies a market niche based around its prime advantage, being longevity, however it was concluded that UHT milk would not be considered a substitute for fresh milk in the minds of a significant number of consumers.
- 39 In relation to the current proposal, although the price of UHT milk is now reasonably comparable to that of fresh milk, staff consider that UHT milk would not be viewed as a substitute for fresh milk in the minds of a significant number of consumers. NZ Dairy noted that sales for UHT milk were not increasing in New Zealand and that New Zealand is very much a fresh milk market.
- 40 Unprocessed or raw milk is acquired from farmers by dairy co-operatives for the manufacture of various dairy products which are sold on either the domestic or export markets. Of total milk produced in New Zealand, between 90-95% is used in the processing of dairy product exports.
- 41 The applicant argues that there is only one market for the manufacture and supply of all fresh dairy products, rather than separate markets for more specific categories of products such as fresh milk and cream, yoghurt, butter, cheese etc.
- 42 The issue of whether the market for the manufacture and supply of dairy products should be separated into separate national markets relating to specific products

¹² Decision 264B, 7 June 1991, see also *NZ Co-operative Dairy Co Ltd v Commerce Commission* [1992] 1 NZLR 601

was addressed in the *NZCDC/East Tamaki*, *NZCDC/Bay Milk* and *Mainland/Kiwi* reports. The general approach taken by the Commission has been to carry out competition analysis in relation to separate markets. This approach has been adopted on the basis that if competition concerns are not identified within a narrower market definition, then they are unlikely to arise in a wider market definition. If no dominance issues arise in a narrowly defined market, it is unnecessary to establish whether specific products do in fact constitute separate markets.

- 43 For the purposes of the current proposal, staff intend to continue the approach previously taken by the Commission in considering business acquisitions in the dairy industry. That is, to carry out competition analysis in relation to separate markets which may otherwise be included in a more general market for the manufacture and supply of dairy products in New Zealand.
- 44 However, staff note the possibility that in the case of some dairy products, a separate product market for each may not be appropriate. There may be some considerations of substitutability in demand or supply which indicate that they form part of a larger product market.
- 45 In the Commission's consideration of *NZCDC/East Tamaki* and *Mainland/Kiwi*, a separate market for the manufacture and wholesale supply of cultured dairy products was identified, due to the similarity of characteristics such as type of manufacture and shelf life. This approach was adopted without attempting to conclude whether this product category constituted a separate market or whether it was part of a wider market for dairy foods. Cultured dairy products include yoghurt, sour cream, cottage cheese and cream cheese.
- 46 Commission staff identified a market for the processing and supply of powdered milk products in New Zealand in the *NZCDC/Waikato Valley Co-operative Dairies Ltd* decision. Most milk powder (about 95%) is sold to the NZDB for

export, however a small amount is sold on the domestic market. Powdered milk is used as an ingredient in the production of other foods (dairy food, stock food and baked goods) and packaged as a separate product.

Functional Level

- 47 Mainland (including its interconnected bodies corporate) and SIDF are involved at the processing and wholesale supply functional levels of the markets for fresh milk and cream, yoghurt and other cultured dairy products, and powdered milk products. They are also involved in the acquisition of unprocessed milk from suppliers.

Geographic Extent

- 48 An important issue in considering the current proposal is the extent of the geographic areas from which the products (identified above) are obtained and supplied; that is, the geographic extent of the markets. In defining the relevant geographic markets, the Commission looks at the practicality of transporting a product by various modes and over various distances and the cost of doing so relative to the value and profitability of the product. The Commission may also examine the scope and spread of advertising by market participants as a possible indicator of the geographic extent of a market.¹³
- 49 The geographic extent of the market for the processing and wholesale supply of town milk has been examined by the Commission on a number of previous occasions, mainly in relation to the North Island. The conclusion reached in recent Commission decisions involving North Island dairy acquisitions has been that the geographic market includes at least the greater part of the North Island.

¹³ Refer Commerce Commission's Business Acquisitions Guidelines, 1996, p13.

- 50 The geographic extent of the market for the processing and wholesale supply of town milk in relation to the South Island was recently considered in *SIDF/Westport United Dairies Ltd* and *SIDF/Grey District Co-operative Milk Producers Association Ltd* and *Scenicland Milk & Cream Ltd*. In those decisions Commission staff concluded that the market included the entire South Island. Those reports noted that since deregulation of the town milk industry, all South Island town milk processors have expanded the geographic coverage of their supply areas. For example, SIDF has extended its coverage to include most of the South Island. Southern Fresh supplies town milk as far north as Rangiora, and Nelson Milk has extended its supply coverage into the West Coast.
- 51 The applicant submits that the market for the processing and wholesale supply of town milk is now a New Zealand wide market. The applicant argues that increasingly, town milk brands like “Anchor” and “Taranua” are sold and advertised nationally, and that contracts for supermarket supply for both proprietary and supermarket house brands are negotiated on a national basis. However, other industry participants were of the view that there is not a national market for the processing and wholesale supply of town milk, but separate North and South Island markets.
- 52 As noted above, while town milk is currently being transported over large distances on an economic basis in the South Island, no town milk is being transported across Cook Strait. Several years ago, Kiwi undertook a trial involving the transportation of unprocessed milk from Southland to Taranaki to assess whether it was technically feasible to do so. While the trial proved “very successful”, Kiwi does not consider that transporting milk across Cook Strait is economically viable at the current time. However, Kiwi does consider that inter-island transportation of town milk is a future possibility.
- 53 NZ Dairy was also of the opinion that the North and South Islands are still quite distinct geographic markets. NZ Dairy stated that while the company will need to

deal more and more with the major customers (eg: supermarket chains and oil companies) on a national basis, it is not involved in transporting town milk across Cook Strait, and does not have any future plans to do so.

- 54 The supermarket chains contacted by Commission staff have North and South Island supply arrangements with the various town milk processors, although some of these supply arrangements are negotiated centrally. For example, Foodstuffs has supply arrangements with SIDF and Mainland for its town milk requirements for its South Island supermarkets. Woolworths has supply arrangements with Nelson Milk and Southern Fresh for its house brands in the South Island and with NZ Dairy for its house brands in the North Island.
- 55 BP also has North and South Island town milk supply arrangements. BP's service stations in the North Island are supplied by NZ Dairy, and its South Island service stations are supplied by SIDF. Shell has supply arrangements with most of the town milk processors in both the North and South Islands, although some of those agreements are negotiated centrally.
- 56 Commission staff note that while it is physically feasible to transport milk across Cook Strait, no town milk processor is currently doing so, or is contemplating doing so in the short to medium term, as it is considered uneconomic. As such, all town milk that is processed in the South Island is sold in the South Island. Consequently, Commission staff consider that it is still appropriate to define the geographic market for the processing and wholesale supply of town milk as encompassing only the South Island.
- 57 Similarly, in relation to the market for the acquisition of unprocessed milk, it is considered appropriate to define a South Island wide geographic market. While it may not be economically viable for suppliers/farmers to transport unprocessed milk from one end of the South Island to the other, nevertheless, transport costs do not appear to represent a major obstacle to its transportation across considerable

distances.

- 58 In relation to the market for the manufacture and wholesale supply of yoghurt and other cultured dairy products, the Commission has previously defined the relevant geographic market as a national one, and Commission staff consider that it is appropriate to adopt that same market definition for the purposes of this report. Existing competitors contacted by Commission staff agreed that improvements in transportation and handling mean that these dairy products are able to be transported around the country, and that a New Zealand wide geographic market definition was accurate.
- 59 Commission staff also conclude that the market for the processing and supply of powdered milk products is a national market, as milk powder is manufactured and supplied throughout New Zealand.

Conclusion on Market Definition

- 60 Commission staff conclude that the relevant markets for the purpose of analysing the competition issues arising from the proposed acquisition are as follows:
- the market for the processing and wholesale supply of town milk in the South Island;
 - the market for the acquisition/supply of unprocessed milk in the South Island;
 - the market for the manufacture and wholesale supply of yoghurt and other cultured dairy products in New Zealand; and
 - the market for the processing and wholesale supply of powdered milk products in New Zealand.

ASSESSMENT OF DOMINANCE

Overview

61 Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

62 Section 3(9) of the Act states that a person is in a “dominant position” in a market if:

... a person as a supplier or an acquirer of goods or services either alone or together with an interconnected or associated person is in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ...

63 That section also states that a determination of dominance shall have regard to:

- market share, technical knowledge and access to materials or capital;
- the constraint exercised by competitors or potential competitors; and
- the constraint exercised by suppliers or acquirers.

64 In reaching a view on whether a person is in a position to exercise a dominant influence in a market, the Commission considers the foregoing non-exhaustive factors and any other relevant matters that may be found in a particular case.

65 In *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554, the Court of Appeal approved the following dominance standard, adopted by McGechan J in the High Court:

...dominance involves more than “high” market power; more than mere ability to behave “largely” independently of competitors; and more than power to effect “appreciable” changes in terms of trading. It involves a high degree of market *control*.

66 A dominance assessment for each of the markets identified above follows.

The Market for the Processing and Wholesale Supply of Town Milk in the South Island (“South Island Town Milk Market”)

67 SIDF, and Mainland to a lesser extent, are both involved in the processing and wholesale supply of town milk and cream in the South Island. The parties supply town milk under the “Meadow Fresh” and “Tatarua” brands respectively. SIDF currently processes and distributes town milk at Christchurch and Dunedin. SIDF is also involved in the supply of supermarket house brand milk to Foodstuffs and Progressive Enterprises. Mainland processes town milk at Timaru, which is distributed via milk vendors around Timaru and to supermarkets from Christchurch to Balclutha.

68 Other participants in the South Island town milk market include Southern Fresh and Nelson Milk. Both companies are involved in the processing and supply of their own milk brands, and the “Anchor” brand through franchise arrangements with NZ Dairy. Nelson Milk also has a minor involvement in the supply of supermarket house brands, supplying one Woolworths’ supermarket (“Big Fresh”) in Nelson. Southern Fresh also supplies Woolworths’ stores with its house brands.

Market Shares

69 In the Commission’s view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist¹⁴:

¹⁴ Refer Commerce Commission’s Business Acquisitions Guidelines, 1996, p17.

- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
- the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share.

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

71 The applicant estimates that the South Island town milk market accounts for approximately 20.6% of the total town milk supply in New Zealand, with market participants having the following market shares:¹⁵

Market Participants	Market Shares
SIDF	69%
Mainland	5%
Combined Entity	74%
Southern Fresh	17%
Nelson Milk	7%
Others	2%
Total	100%

72 Southern Fresh did not believe that it would have as high a market share as 17%, but agreed with the market share estimates for other market participants. NZ Dairy estimated that the combined entity would have a market share of approximately 70%. On the basis of the information provided by the applicant and other existing competitors, Commission staff conclude that the above market share figures are realistic. Consequently, the combined entity’s market share

¹⁵ Estimates include market participants’ involvement in the supply of supermarket house brands.

would fall outside the Commission's "safe harbours".

- 73 Whether a dominant position would exist in a market following implementation of a proposed acquisition is not determined on the basis of market share analysis alone. As Tipping J stated in *New Zealand Magic Millions Ltd & Anor v Wrightson Bloodstock Ltd* (1990) 3 NZBLC 99-175:

... market share is not the sole determinant of the presence or absence of dominance or market power. The most that can be said is that dominance is frequently attended by a substantial market share but all other relevant factors must be brought into account. For example, a substantial market share without barriers to entry will seldom, if ever, be indicative of dominance.

- 74 Accordingly, the Commission considers a range of additional factors before reaching a conclusion about the acquisition or strengthening of a dominant position in a market, such as the constraint from existing and potential competition, barriers to entry, and the constraint from buyers. These additional factors are discussed below.

Constraint from Existing Competition

- 75 Mainland submits that the proposal does not result in any materially greater market share and no greater market power on the part of Mainland than the status quo for SIDF, particularly considering that Mainland's small market share in the South Island is concentrated in Timaru. Further, Mainland argues that the retail supply of town milk (and other dairy products) is moving towards a position where there will only be two main suppliers of town milk in New Zealand, Mainland and NZ Dairy. As such, the applicant submits that there is, and will continue to be, strong competition in the South Island town milk market from NZ Dairy, through its franchise holders and as an independent entity.

76 Southern Fresh and Nelson Milk both agreed that continued rationalisation of the town milk industry in New Zealand is inevitable and did not express any major concerns in relation to the proposed acquisition. They considered that they would continue to be able to compete in the market after implementation of the proposal, although it was agreed that the combined entity would be a very strong competitor. Expansion was also considered possible. For example, it was noted in *SIDF/Westport United Dairies Ltd* that expansion by an existing town milk processor in the South Island was feasible, and that both Southern Fresh and Nelson Milk appeared capable of increasing the volume of milk they already supplied with relative ease, and in a timely manner.

77 However, given the comparatively low market shares for existing competitors, and their physical locations at either end of the South Island, Commission staff conclude that existing competition may not provide sufficient constraint on the combined entity such as to alleviate dominance concerns.

Constraint from Market Entry

78 It is necessary to determine whether the combined entity would be subject to significant constraints from the threat of market entry. Potential competition which could act as a constraint could come from either new entry to the market or imports. Before the Commission will consider that new entry will provide an adequate constraint on a merged entity so as to allay dominance concerns, such entry must be shown to be *likely*, of sufficient *extent*, *timely* and *sustainable* (the “*lets*” test).¹⁶

79 The applicant submits that all dairy co-operatives are financially and technically able to enter the South Island town milk market, and particularly, that NZ Dairy could enter the market by shipping milk from the North Island or by commencing processing in the South Island. [

¹⁶ Commerce Commission’s Business Acquisitions Guidelines, 1996, pp19-20.

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- 80 As previously stated, while town milk is currently being transported considerable distances within the North and South Islands, no milk is being shipped across Cook Strait. For example, Mainland currently line hauls packaged milk from Longburn to Wellington and Auckland. NZ Dairy line hauls packaged milk from Auckland to Wellington. Commission staff conclude that although it is not economically viable at the present time, the inter-island transportation of town milk may be viable in the future.
- 81 As noted in previous reports, entry may also be achieved by one of the existing manufacturing dairy co-operatives diversifying into town milk processing. For example, Mainland argues that both the Alpine and Marlborough manufacturing dairy companies are active on the domestic market in relation to dairy products, and have the infrastructure, brands and knowledge to enter the town milk market if they chose to do so.
- 82 It was noted in *SIDF/Westport United Dairies Ltd* that Westland Co-op Dairy Co Ltd considered that it would be feasible for the company to enter the town milk market, although it had no current plans to do so. A number of other manufacturing dairy companies contacted by Commission staff also considered that it was financially and technically possible to enter the town milk market with little difficulty, although such entry would depend on securing access to a regular supply of unprocessed milk on a year-round basis.
- 83 The applicant also submits that supermarkets could enter the market via, for example, a joint venture arrangement with a dairy co-operative. Such market entry has been discussed in previous Commission reports relating to the dairy industry. For example, supermarket chains told Commission staff during the

examination of the *Kiwi/Tui* proposal that although they did not have any current intentions to investigate such a proposal, they could do so if circumstances changed. Commission staff consider that, while possible, such entry is unlikely in the short term and so would not provide a competitive constraint on the activities of the combined entity.

Conclusion on Constraint from Market Entry

84 Commission staff consider that [

]. Commission staff note that it would be comparatively easy for other dairy co-operatives to enter the town milk market if they chose to do so. As such, Commission staff conclude that the combined entity will be subject to significant constraint from the threat of market entry.

Constraint from Buyers

85 The supermarket chains, oil companies, and milk vendor groups are the major acquirers of town milk in New Zealand. For example, supermarkets account for between 30% and 40% of total town milk retail sales. This figure is subject to some regional variation as a higher proportion of town milk is sold through milk vendors in the South Island.

86 The applicant submits that the three supermarket chains have a significant degree of countervailing power in the market and are in a position to constrain the combined entity if it was to increase prices or reduce the quality of its services. This view was shared by other market participants contacted by Commission staff.

87 Further, the applicant submits that [

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88 Supermarkets sell the dairy companies' proprietary town milk brands, as well as their own house brands,¹⁷ with house brand milk sales accounting for more than one third of total supermarket milk sales. Specifically, house brands account for approximately 35% of supermarket town milk sales on a national basis, and approximately 46% of such sales in the South Island. The applicant estimates and Commission staff have confirmed that milk sales in South Island supermarkets are as follows:

Milk Brand	Market Share (for 6 months ended 22 March 1998)
Meadow Fresh	31.2%
Pak 'n Save house brand	16.0%
Anchor	14.6%
Pams house brand	14.1%
Countdown house brand	7.0%
Super Pac house brand	5.2%
So Fresh	3.1%
No Frills house brand	2.8%
Tararua	1.2%
First Choice house brand	1.0%
Others	3.8%
Total	100%

89 The supermarket chains contacted by Commission staff did not consider that the proposed acquisition would have a significant effect on the range of supply options available to them and agreed that they are able and willing to switch between processors for the supply of their house brands.

¹⁷ For example, Woolworths sells house brand milk under the "No Frills" and "First Choice" brands, Progressive sells house brand milk under the "Countdown" brand, and Foodstuffs sells house brand milk under the "Pams" and "Budget" brands.

- 90 The oil companies also have a degree of bargaining power in the market as an increasing volume of milk is being sold through service stations (at the expense of home delivery and corner dairy sales). It is also noted that there is a trend towards oil companies negotiating nationwide purchasing contracts with processors for the supply of town milk to service stations.
- 91 Milk vendors, involved in the supply of town milk for home delivery and to dairies and other convenience stores, deliver between 60% and 70% of all town milk sold in New Zealand. Again, it is noted that this figure is subject to regional variation. The National Milk Vendors Association, which represents milk vendors New Zealand wide, noted that the home delivery market is particularly strong in the South Island, where approximately 40% of all town milk is home delivered.
- 92 The applicant submits that milk vendor groups have a degree of countervailing power in the market because of this high market share and their ability to move from one town milk processor to another. However, other market participants expressed the view that milk vendors were essentially “price takers”, and were in an increasingly vulnerable position because of the growth in milk sales through supermarkets and service stations. Commission staff conclude that milk vendor groups would have little countervailing power in the South Island town milk market.

Conclusion on Constraint from Buyers

- 93 Commission staff conclude that supermarkets and oil companies have considerable countervailing power in the South Island town milk market and will act as a significant constraint on the combined entity. However, milk vendor groups would appear to have little countervailing power in the market.

Conclusion on Assessment of Dominance in the Market for the Processing and Wholesale Supply of Town Milk in the South Island

- 94 Although the combined entity will have a comparatively high market share in the South Island town milk market, falling outside the Commission's "safe harbours", the constraints from existing and potential competitors and the countervailing power of supermarkets and oil companies would be sufficient to alleviate dominance concerns in the market. Accordingly, Commission staff conclude that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the processing and wholesale supply of town milk in the South Island.

The Market for the Acquisition/Supply of Unprocessed Milk in the South Island

- 95 As dairy co-operatives, both Kiwi (through its subsidiary Kiwi Dairies (South Island) Ltd) and SIDF are involved in the acquisition of unprocessed milk in the South Island, from their suppliers/members.
- 96 On the basis of information provided by the applicant and other dairy companies, existing shares in the market for the acquisition of unprocessed milk in the South Island are as follows:

Dairy Company	Location	Litres p.a. (millions)	Market Share %
Kiwi (South Island)	Dunedin	160	8%
SIDF	Christchurch	170	9%
Combined Entity		330	17%
Alpine*	Clandeboye	598	31%
Southland*	Edendale	515	26.5%
Westland	Hokitika	270	14%
Marlborough	Tuamarina	60	3%
Tasman	Takaka/ Brightwater	140	7%
Kaikoura	Kaikoura	30	1.5%
Total		1,943	100%

*as noted above, Alpine and Southland have recently announced that they propose to merge

- 97 The combined entity's market share would fall within both of the Commission's "safe harbours", being less than in the order of a 40% share of the market, and being less than in the order of a 60% share of the market while facing competition from at least one other market participant having no less than in the order of a 15% market share.

Concerns Raised by Unprocessed Milk Suppliers to Cadbury Confectionery Ltd

- 98 The Commission has received several submissions against the proposed acquisition from a group of South Island dairy farmers who are currently supplying Cadbury Confectionery Ltd ("Cadbury"). Cadbury has recently given notice that it will be terminating these agreements for supply, choosing instead to source its unprocessed milk requirements from SIDF effective from 1 September 1998.
- 99 As part of its agreement for supply to Cadbury, SIDF had undertaken to accept this group of farmers as members of SIDF provided that they met the usual standards of the company (in some cases this involved upgrading existing milking facilities and improving access to farms). However, post acquisition SIDF would no longer exist, and the Cadbury suppliers would have to apply to become

members of Kiwi. Their main concern was that they would not be accepted by Kiwi because of the small volumes produced by some of them, and inadequate access roads for the large tankers used by Kiwi for milk collection.

100 Kiwi has stated that, providing the Cadbury suppliers meet Kiwi's standards and entry requirements, there is no obstacle to them becoming supplier members. In a few cases, resolution of other issues such as access by tanker and minimum farm milk output volumes will also be necessary. Kiwi's entry standards apply nationally, and require new suppliers to acquire equity in the co-operative's assets (as with other dairy co-operatives).

101 Considering the above information, Commission staff conclude that the submissions received by the Commission from the Cadbury suppliers do not raise competition issues in relation to the proposed acquisition.

Conclusion on Assessment of Dominance in the Market for the Acquisition/Supply of Unprocessed Milk in the South Island

102 Commission staff conclude that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the acquisition/supply of unprocessed milk in the South Island.

The Market for the Manufacture and Wholesale Supply of Yoghurt and Other Cultured Dairy Products in New Zealand

103 Estimates of market shares provided by the applicant (and verified by other market participants) are as follows:

Supplier	Market Share
Mainland	14%
SIDF	10%
Combined entity	24%
NZCDC	54%
International Fine Foods	18%
Other suppliers	4%
Total	100%

104 As the market share of the combined entity would fall within both of the Commission's safe harbours, being a share less than in the order of 40%, and less than in the order of 60% while facing competition from at least one other market participant having no less than in the order of 15%, Commission staff conclude that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the manufacture and wholesale supply of yoghurt and other cultured dairy products in New Zealand.

The Market for the Processing and Wholesale Supply of Powdered Milk Products in New Zealand

105 The applicant submits that the milk powder plant to be acquired by Kiwi uses surplus milk during the summer supply peak period that is not required for consumer products and fresh milk supply for the production of milk powders to be sold predominantly on the export markets.

106 The applicant estimates that the inclusion of SIDF's volumes will increase Kiwi's share of the domestic powdered milk product market from an estimated 20% to close to 30%. However, the applicant also noted that considering the age of the SIDF plant and relative returns, it is possible that surplus milk used for powder may be diverted to other uses in the future.

107 The main competitors of Kiwi and SIDF in the domestic powdered milk product market are NZCDC and Northland Dairy Co-op Ltd. NZCDC stated that it did not

have any market share data relating to this market as it is relatively insignificant compared to the export markets. As mentioned earlier, around 95% of milk powder product is exported via the NZDB. Northland Dairy estimated the combined entity's market share as []%, and noted that SIDF is not particularly active on the domestic market.

- 108 The pricing for milk powder products is primarily determined by the export markets. In 1997, the New Zealand dairy industry produced 374,000 tonnes of milk powder product. Of their total milk powder production, SIDF and Kiwi sold 29% and 4% respectively on the domestic market, and 71% and 96% respectively on the export markets.
- 109 Northland Dairy considered that it would be very easy for a dairy company primarily supplying the export markets to switch to supplying more product to the domestic market. Milk powder product destined for the export markets via the NZDB is often stored for some time. Some of this product could easily be diverted to the domestic market if necessary.
- 110 The applicant's market share estimate for the combined entity (30%) may be overstated, however the Commission considers that a conservative assessment of market concentration is appropriate¹⁸. This market share estimate would fall within both of the Commission's "safe harbours", being a share less than in the order of 40%, and less than in the order of 60% while facing competition from at least one other market participant having no less than in the order of 15%.
- 111 Commission staff therefore conclude that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the processing and wholesale supply of powdered milk products in New Zealand.

¹⁸ Commerce Commission's Business Acquisitions Guidelines, 1996, p17.

OVERALL CONCLUSION

- 112 Although implementation of the proposal would lead to aggregation and a comparatively high market share in the market for the processing and wholesale supply of town milk in the South Island, Commission staff consider that the proposal would not result, and would not be likely to result, in the combined entity or any other person acquiring or strengthening a dominant position in this market. There would appear to be sufficient competitive constraints from existing and potential competition, combined with the significant countervailing power of major buyers, to eliminate concerns that the combined entity or any other person would, or would be likely, to acquire or strengthen a dominant position in this market. In the other markets affected by the proposal, the market shares of the combined entity fall within both of the Commission's "safe harbours". As such, Commission staff conclude that no dominance concerns arise.
- 113 Having regard to the factors set out in s 3(9) of the Act and all other relevant factors, Commission staff conclude that the proposal would not result, and would not be likely to result, in the combined entity or any other person acquiring or strengthening a dominant position in any of the following markets:
- the market for the processing and wholesale supply of town milk in the South Island;
 - the market for the acquisition/supply of unprocessed milk in the South Island;
 - the market for the manufacture and wholesale supply of yoghurt and other cultured dairy products in New Zealand; and
 - the market for the processing and wholesale supply of powdered milk products in New Zealand.

RECOMMENDATION

- 114 It is recommended that, in terms of s 66(3)(a) of the Act, the Commission give clearance for the proposed acquisition.

John Preston
Chief Investigator

Jane Chilcott
Investigator

Juliet Fletcher
Investigator

DETERMINATION ON NOTICE OF CLEARANCE:

MAINLAND PRODUCTS LIMITED/SOUTH ISLAND DAIRY FARMERS CO-OPERATIVE LIMITED

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3) of the Commerce Act 1986, we hereby give/decline to give clearance for the acquisition by Mainland Products Limited, or any of its interconnected bodies corporate, of the fresh milk and cream, and yoghurt and other cultured dairy food assets of South Island Dairy Farmers Co-operative Limited, as described in Appendix 1 to this decision.

Dated this day of May 1998

T G Stapleton
Deputy Chairman

K M Brown
Member

R N Taylor
Member