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PUBLIC VERSION

COMMERCE COMMISSION

Decision No. 401

Determination pursuant to the Commerce Act 1986 in the matter of an application involving:

MONTANA GROUP (NZ) LTD

and

CORBAN WINES LTD

The Commission:	John Belgrave Cathie Harrison Paula Rebstock
Summary of Application:	The acquisition by Montana Group (NZ) Ltd of up to 100% of Corban Wines Ltd.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	September 2000

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THE PROPOSAL

1. In a notice to the Commission dated 11 August 2000, pursuant to section 66(1) of the Commerce Act 1986 ("the Act"), Montana Group (NZ) Ltd ("Montana") sought clearance to acquire a 100% share of Corban Wines Ltd ("Corbans").

THE PROCEDURES

2. The application was received on 11th August 2000. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period.
3. The applicant agreed to an extension to a decision date of 6th September 2000.
4. In the application, Montana had not sought confidentiality as to fact of the proposed acquisition, but had requested confidentiality for specific information contained in or attached to the notice. It considers that disclosure of that information could result in "material financial loss and prejudice to the competitive nature of the parties". A confidentiality order was subsequently made in respect of that information in respect of that information for a period of 20 working days from the Commission's determination of the notice. When that order expires, the provisions of the Official Information Act 1982 will apply to the information.
5. The Commission's decision was based on an investigation conducted by its staff, and their subsequent advice to the Commission. In the course of this investigation, Commission staff discussed the application with a large number of parties including:
   - Grape growers
   - Wine makers
   - Wine importers
   - Major retailers of wines (eg supermarkets etc)
   - Wine clubs
   - The Wine Institute of New Zealand
   - Wine Growers Association
   - Wine Makers Association
   - Restaurant Association
   - Other industry bodies

THE PARTIES

Montana Group (NZ) Ltd

6. Montana is a domestic producer and supplier of international wines and is involved in growing grapes, buying grapes, making grapes into wine, and retailing wine. Montana also bottles wines, and acts as a national distributor for five other New Zealand wine companies and ten foreign wine companies. A list of all brands distributed by Montana including its own and those that Montana is an agent for are listed in Appendix A.

7. Montana owns wineries and vineyards situated in Gisborne, Hawkes Bay, and Marlborough, and one bottling/finishing plant in Auckland. It also purchases grapes from independent growers in these regions on contract.

8. Montana first started producing grapes in 1934 although it only became incorporated as a company in 1961. It was floated in 1973 and is currently a publicly listed company. Lion Nathan Enterprises Ltd currently holds 24.96% of ordinary shares although, subject to the consent of the Overseas Investment Commission, it intends to increase this holding by a further 3.3%.

9. Both Lion Nathan and Montana have a number of trading and non-trading subsidiaries. Those relevant to this application are listed in Appendix B.

10. Montana Wines is the largest supplier of wine in New Zealand with turnover of $205 million for the 1999 financial year.

Corban Wines Ltd

11. Corbans was established in 1902. Today the company is owned by publicly listed DB Group Ltd. Subsidiaries owned by Corbans which are relevant to this application are listed in Appendix B.

12. Corbans operations are similar to Montana's. It owns vineyards and wineries in Gisborne, Hawkes Bay, and Marlborough, and buys from independent wine grape growers from throughout New Zealand. Corbans produces wine for supply to the New Zealand market and export markets. Corbans does not distribute wine for other New Zealand or foreign wine makers. A list of Corbans brands are listed in Appendix A.

13. Corbans exports to more than 18 countries around the world. One of its brands - Stoneleigh - is reputedly the most widely available New Zealand wine in the world.

14. Corbans is the second largest supplier of wine in New Zealand with turnover of $120 million for the 1999 financial year.

BACKGROUND

Global wine industry

15. France is recognised as the premier producer of wine, producing 5.3 billion litres in 1997. Italy followed close behind with production of 5 billion litres, and Spain was third with 3.3 billion litres. These three countries account for around 54% of global production. New Zealand in comparison had production of around 45 million litres, or around 0.2% of world production.

16. Global demand for wine has remained reasonably static over the last five years. There has been a trend towards red wine as evidence of its health benefits have become known.

17. Global supply has declined over the last eight years, in response to consumption patterns. Large increases in plantings, principally in Australia and USA, has led analysts to predict huge over-supplies of grapes, and hence wine in the near future. The effect of this oversupply is likely to lead to falling world prices for wine, plus global consolidation.[1] As it is, the global industry is extremely fragmented, with Gallo, the

[1] *See* "18 December 1999 UK Wine Survey – Glug, glug, glut", *The Economist*, 18/12/1999.

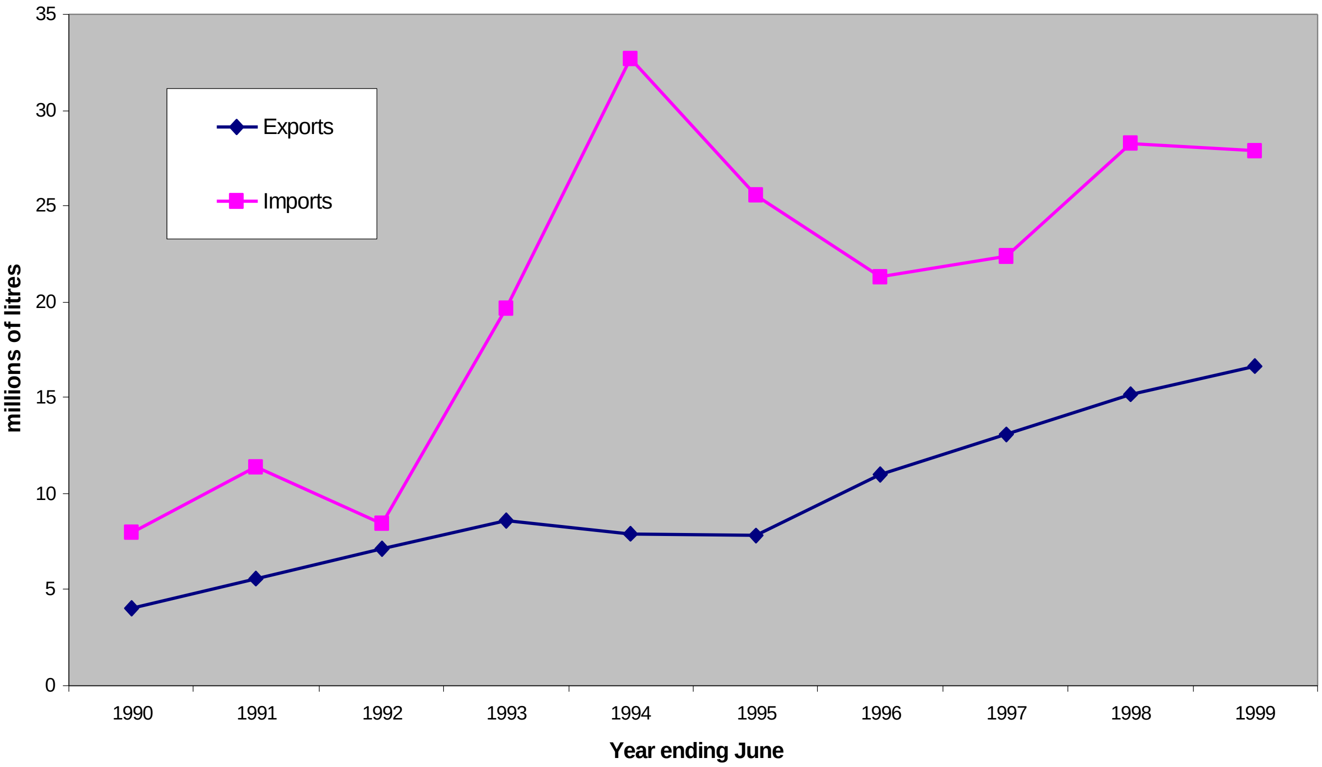
world's largest supplier of wine, reputedly only accounting for around 1% of world supply.

NZ Wine Industry

18. The earliest recorded instance of wine making in New Zealand was in 1840, but it has only been in the last thirty years, that New Zealand wine has been produced and consumed at significant levels. Prior to this the New Zealand wine industry was considered an "inward-looking industry producing cheap and bad quality wine".[2] The mid-eighties, however, saw a change in government policy and an opening up of the market. Since this time the wine industry has grown significantly, both in terms of production and consumption.

19. New Zealand wines have a strong reputation overseas as being quality wines. In Britain, New Zealand wine fetches a higher per unit value than any other imported wine. In particular, New Zealand's Sauvignon Blancs and Chardonnays are popular.

Figure 1:
Total Wine Exports and Imports



20. International wine awards have raised the profile of New Zealand wines and helped the export market to grow at significant rates. Figure 1 illustrates the steady growth of exports, with wine export sales increasing from 4 million litres to 16.6 million litres in the period 1990 to 1999. By far the biggest market for the year ending June 1999 was the UK (9 million litres), followed by Australia (2.2 million litres) and USA (1.4

[2] *See* "The Impact of Liberalisation: Communicating with APEC Communities – Wine Industry in New Zealand", Mia Mikic, November 1998.

million litres). Total exports for the 2000 year is expected to exceed 19 million litres, which equates to around $165 million in earnings. Around a quarter of all wine produced in New Zealand is now exported.

21. Consumption in New Zealand has steadily increased over the last thirty years. As an indication, table wine consumption per capita in 1998 was 16.1L, which represents a 186.5% increase from 1970.[3] A lot of this increase in demand has been accounted for by imports, principally Australia. Imports have grown steadily since the eighties and now account for around a quarter of all domestic consumption. This is up from around 4% in the late seventies.

22. The number of New Zealand wineries has grown significantly in the last ten years. In March 2000 there were around 358 wineries in New Zealand which is roughly double that of 1994.[4] Many of these are small boutique wineries, making wine as much for the lifestyle as for commercial purposes.

23. The main governing body for wine makers is the Wine Institute of New Zealand. For its purposes the Wine Institute divides wineries into three categories based on the winery's sales. The categories are:

Category I: Annual Sales < 200,000 litres

Category II: Annual Sales between 200,000 and 2,000,000 litres

Category III: Annual Sales > 2,000,000

24. Although there has been substantial growth in the number of wineries in the last ten years, the majority have been in category I, in the form of boutique wineries. As an indication, it is noted that in 1999 the average size of vineyards was 10.5 Ha although the median size was only 5.0 Ha indicating the distribution is heavily skewed. The industry could thus be loosely described as being made up of large commercial firms and small boutique wineries.

25. Recent changes in liquor laws have significantly changed the way wine is sold. The main changes included: allowing supermarkets to stock beer, trading alcohol on Sundays, and lowering of the drinking age to 18. The effect has been a shift in alcohol purchases from traditional liquor outlets to supermarkets. Wine purchases in supermarkets have grown at around 15% since the law changes, mainly at the expense of the traditional liquor outlets. Supermarkets are now the main distribution outlet for wine accounting for around 50% of all wine sales.

Process of wine making

Grape Growing

26. Climate and soil are important for grape growing. In general, the soil should be dry as excessive water will be drawn into the grape and dilute the flavours. Soil with high stone content tends to allow water to drain away quicker and therefore is conducive to grape growing. Climate is also important, as the best growing conditions include plenty of sunshine, hot summers and cold winters. Other factors that affect the vine yield are good trellis construction, viticultural and irrigation techniques, and the timing of grape picking.

[3] <http://www.alcohol.org.nz>

[4] These figures are based on Wine Institute membership, which is compulsory for wine makers.

27. It normally takes at least two years to start producing grapes from when the vines are first planted. It may take a further one to two before economic returns are realised and another year before full production is reached. If the rootstock is already established however, it is possible to switch varieties by "grafting" the new variety onto the rootstock and generally be close to full production within two years. This is commonly done by growers in response to supply and demand factors for the respective varieties.

28. Although wine is a high value added product, grapes are still basically an agricultural commodity. Growing grapes for wine is thus unpredictable, and harvests can fluctuate quite dramatically. The grapes are particularly susceptible to climatic conditions. For example, unsuitable weather meant there was poor flowering in Marlborough last year, which resulted in the Sauvignon Blanc crop being down 35% from the previous year. This shortage in turn affected the crop price. It is understood grape juice was being sold for up to $7 a litre as compared to $3 a litre last year. Bad crops, however, are typically compensated for somewhat by a good crop the following year.

29. The quality of the grape can be greatly affected by the amount the bunches are thinned. If the grower thins the grape bunches then each grape will get more exposure to sunlight. This improves the quality of the grape. Leaving the grapes in large bunches has the reverse effect.

Wine Making

30. A basic description of the white wine making process is as follows:

    i. The grapes are crushed and stems removed.

    ii. The crushed grapes are transferred to a pressing machine which squeezes the juice out of them.

    iii. The juice is put in a tank for fermentation. Extra sugar may be added at this stage, if the grapes are naturally low on sugars.

    iv. The juice is aged either in stainless steel vats or oak barrels. Ageing the wine in oak barrels is the more traditional method and is said to produce a better flavour as the wood naturally imparts tannins and other flavours. The process of ageing can last for a few months or several years.

    v. At this stage the wine maker may choose to blend the juice with other varieties to achieve particular flavours.

    vi. Following ageing (or blending, as the case may be) the wine is chilled for a few weeks to precipitate any unstable compounds.

    vii. The wine is filtered to remove any further impurities and then bottled.

31. The above describes the basic steps, although variations commonly exist. The process of making red wine is very similar, however there is a slight variation in the order in which the grapes are fermented. The red colour is derived from pigments in the skin, which are not present in the juice or flesh. The grapes are thus fermented with their skins on, prior to being pressed. Basically, the order of steps "ii" and "iii" above are reversed, with everything else remaining essentially the same. It is noted that during the prolonged fermentation period of reds, additional tannins and flavours are extracted, which explains the extra body of red wines compared to whites.

32. Sparkling wine involves a different process. To produce the “sparkling” characteristic, carbon dioxide produced during fermentation is trapped within the bottle. Extra sugar and yeast are added to white wine to allow further fermentation. In New Zealand, Chardonnay and Pinot Noir are the grapes typically used to make sparkling wines.

33. Fortified wines are made from both white and red grape varieties. Additional alcohol is added, along with brandy to make fortified wines a sweet, high alcohol wine. Typically, Sherry is made from white grape varieties, and Port red grape varieties, however, the Commission understands that there are few rules governing the making of fortified wines so Port can be made with white grapes by adding colouring.

34. Liquor laws restrict supermarkets from selling alcohol with content greater than 16%. This precludes most fortified wines. However, some companies, including Montana and Corbans, specially produce low-alcohol fortified wines to enable them to sell fortified wines in the supermarkets.

35. The grower of the grape is not necessarily the person who makes the wine. A significant proportion of grape growers do not make wine, and are contracted to supply wine makers. In general, the larger wine makers are net buyers of grapes. For example, in 1990 contract growers supplied more than 75% of the country’s grapes.[5] This statistic, however, is understood to have declined over the last decade with wine makers investing more in their own land. This is to improve control over quality of the grapes and to ensure grape supply.

36. Typically, the grapes will be processed in the same vicinity as they were grown. It is understood that this ensures the grapes are of optimal quality, as some quality can apparently be lost in transport. Notwithstanding this, it is common for grapes to be transported significant distances for processing. [ ], for example, transports its grapes overnight from as far as Hawkes Bay to its processing plant in Auckland. [ ].

37. Bottling is often out-sourced by the smaller wineries, although a number of the category II wineries have their own bottling facilities. Montana and Corbans both operate bottling plants in Auckland. This is the most economical approach as Auckland is where most wine is sold and where the bottles are manufactured.

38. Bottled wine is typically supplied in 750 ml bottles. A large proportion of the wine market, however, is supplied in 3L card-board casks.

Regions

39. There are three main wine producing regions in New Zealand, those being Marlborough, Hawkes Bay, and Gisborne. In addition, grapes are grown in Canterbury, Auckland, Wairarapa, Nelson, Waipara, and Central Otago, although these regions do not produce the same volumes of grapes or carry the same reputation as the three main regions. In terms of grape tonnage, Otago has grown the fastest. In 1997 Otago produced around 230 tonnes, while in 1999 produced over 1500 tonnes. Table 1 below sets lists the eight main regions in terms of vintage size.

[5] *See* Decision 263 “The New Zealand Grape Growers Council Incorporated” (authorisation application), p. 6.

Table 1:

Main Regions in Terms of Vintage Size

Region	1999 Vintage (tonnes)	1999 vine area (hectares)
Marlborough	29,229	3,477
Gisborne	22,133	1,447
Hawkes Bay	19,472	2,336
Canterbury	1,551	363
Auckland	1,224	345
Otago	1,094	207
Nelson	1,383	175
Wellington	607	281

40. It is noted that the hectares in Table 1 do not necessarily correspond to the vintage. This is because the different regions tend to focus on different varieties, which in turn have different yields per acre.

Marlborough

41. Marlborough is the largest grape growing region in New Zealand, producing approximately 29,000 tonnes in 1999. In particular, Marlborough is known for producing grapes for Sauvignon Blanc wine. Marlborough also produces significant amounts of Chardonnay and Riesling grapes. Marlborough is where most of New Zealand's champagne-method sparkling wines are made.

42. Marlborough's characteristics are good for grape growing. Despite being cool compared to (say) Australia it is relatively dry, has high annual sunshine hours and shingly soil which is suitable for cool-climate grape-growing. Recognition of this has resulted in increases in vine plantings in Marlborough recently, and rising land prices.

Gisborne

43. Gisborne is the second largest grape producing region in terms of tonnage, producing around 22,000 tonnes in 1999. Gisborne is recognised as producing the best Chardonnay grapes in New Zealand, while also producing good Muller Thurgau.

44. Gisborne is known for having deep, fertile soils, and although it does not have the highest sunshine hours, it is the warmest of the major wine regions. The rainfall is also higher than other regions, meaning very little irrigation is required. Gisborne has been historically known for producing bulk amounts of grapes although its focus has shifted somewhat in recent years. Gisborne's main problem is humidity which is very high compared to other regions. Chardonnay, however, is understood to be one of the "least fussy" of the grape varieties in terms of soil requirements and climate and therefore grows well in Gisborne.

Hawkes Bay

45. Hawkes Bay is New Zealand's third largest grape growing region in terms of tonnage, producing approximately 19,500 tonnes in 1999. Hawkes Bay is mainly known for red varietals, notably Merlot and Cabernet Sauvignon, but also produces good Chardonnay and Sauvignon Blanc.

46. Hawkes Bay has high sunshine hours and warm summers comparable to Bordeaux in France. Although the soil type in the area varies, it is predominantly gravel based ensuring good drainage qualities, although in general it has low rainfall.

Varieties

47. The variety of a wine is determined by the grape used. The most common grape varietal grown is Chardonnay, followed by Sauvignon Blanc. It is likely, however, that Sauvignon Blanc will overtake Chardonnay due to recent plantings, principally in the Marlborough area. Table 2 gives the main varieties grown in 1999.

Table 2:

Main Varietals in Terms of Vintage Size

Variety	1999 Vintage (tonnes)	1999 Producing grape area (hectares)
Sauvignon Blanc	20,580	2,008
Chardonnay	17,823	2,449
Muller Thurgau	8,941	520
Pinot Noir	4,844	826
Muscat Varieties	3,885	191
Cabernet Sauvignon	3,723	653
Riesling	3,462	432
Merlot	3,250	535
Semillon	2,593	215

48. Sauvignon Blanc is New Zealand's most well-known wine variety overseas.

Relevant Legislation

49. The relevant legislation for the industry is the Wine Makers Act 1981 and the Wine Makers Levy Act 1976.

Wine Makers Act 1981

50. Under the Wine Makers Act 1981 a wine maker must have a licence to produce wine (of either the grape or fruit variety). It further specifies the conditions under which

licences will be given and revoked. In general, a licence will not be granted unless the Licensing Authority is satisfied:

- the applicant is a fit person to be the holder of such a licence; and
- the premises in which the wine is to be made, and the equipment in the premises, are suitable for the making, storage, and sale of wine of the kind to which the application relates and are in a proper sanitary condition.

The licence must be renewed annually and can be revoked if the licensee is convicted of an offence against any of the provisions of:

- The Wine Makers Act 1981
- The Health Act 1956
- The Sale of Liquor Act 1989
- The Customs and Excise Act 1996
- The Food Act 1981

51. A license may further be subject to such conditions as the Licensing Authority thinks fit, including any condition designed to ensure that the product as bottled, labelled, and marketed is readily distinguishable from any other kind of liquor.

Wine Makers Levy Act 1976

52. The Wine Makers Levy Act 1976 governs paying of levies paid by wine maker licence holders to the Wine Institute of New Zealand. It also specifies the purposes for which the levies will be used. Generally, this includes "…the promotion, development, and organisation of the wine making industry". More specific descriptions of how the levies may be spent are contained within section 9(2)(a) to 9(2)(m) of the Wine Makers Levy Act 1976.

53. Every person who is liable to pay a levy under this Act to the Institute is entitled to membership of the Institute plus all benefits that flow from membership.

MARKET DEFINITION

Introduction

54. The purpose of defining a market 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 any market in terms of section 47(1) of the Act.

55. Section 3(1A) of the Act provides that:

> ". . . 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."

56. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[6] *Commerce Commission v Carter Holt Harvey Building Products Limited*,[7] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[8] A brief outline of the principles follow.

57. Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

58. A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the *"ssnip"* test), assuming that other terms of sale remain unchanged.

59. Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. 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".

Relevant Markets

Product Market

60. The applicant has submitted that, based on the common business activities of Montana and Corbans, the proposed acquisition will have competition implications for the following markets:

- The national market for the production and supply of wine producing grapes; and,

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[6] (1991) 4 TCLR 473.
[7] Williams J, 18 April 2000, HC, yet to be reported.
[8] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

- The national market for the production and supply of wine.[9]

Production and Supply of Wine Producing Grapes

61. The applicant has recognised that the proposed acquisition will result in aggregation in terms of the "development of land suitable for grape growing". The Commission, however, recognises suitable land as being a essential input into grape growing so will instead consider this as a condition of entry.

62. The Commission recognises that winemakers will have specific needs for grapes depending on what variety/type they wish to make. For example, a maker of Chardonnay must use Chardonnay grapes (or else the wine is not a Chardonnay). However, the Commission considered whether defining individual markets for each variety of grape would make a material difference to the analysis and decided it would not. Therefore, for pragmatic reasons the Commission has in this instance taken a broader market definition.

63. The Commission concludes that for the purposes of the competition analysis, the relevant market is for all wine producing grapes.

Production and Supply of Wine

View of the applicant

64. The applicant considers the wine market to include all varieties and styles of wine because in its view:

"on the demand side, consumers readily substitute between varieties of wines (for example, Chardonnay, Sauvignon Blanc, Sparkling, Cabernet Sauvignon/Merlot, fortified wines) and between differently packaged wine."

Similarly, for the supply side the applicant submits:

"…most winemakers produce all varieties of wine, and will switch emphasis to particular varieties in response to market demand."

65. With respect to "the production and supply of wine", defining such a market would be consistent with previous decisions (see Decision 93, Cooks and McWilliams, 30 August 1984; Decision 263, The New Zealand Grape Growers Council Incorporated; *re Magnum Corporation Limited – Dominion Breweries Limited* (1987) 1 NZBLC (Com)). Notwithstanding these approaches to market definition, the Commission considered alternative market definitions.

Industry Views

66. The Commission has discussed with a range of industry parties whether separate markets existed for the different types of wine (red, white, sparkling, fortified). Most parties felt that consumers had fairly strict preferences for white or red and would not normally switch even if a *ssnip* were to be imposed. However, these comments were mainly based on anecdotal evidence.

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[9] The applicant recognised that the market definition which most easily enabled the Commission to analyse the application was one that included only wine products. The applicant, however, reserved the right to argue a market definition that encompassed all alcoholic beverages.

67. It was noted that reds and whites have very different characteristics. Demand, however, is based very much on trends and fashion at a given time. For example, since recent indications of possible health benefits of red wines there has been a global shift to this type from white wines.

68. Most industry parties spoken to agreed that a separate market existed for sparkling wines.[10] This was based on the view that sparkling wines were purchased for special occasions. Still wines would not be a close substitute in this respect.

69. Fortified wine is much sweeter than still wines, typically presented differently, and has a much higher alcohol content (on average around 18% compared around 10% for table wine). Again, fortified wines are consumed for very different reasons compared to still and sparkling wines, often as an aperitif or desert wine, rather than during the meal. Industry sources, therefore, were generally of the view fortified wine was in its own market.

Arguments for a Single Wine Market

70. Despite the submissions made by industry parties on the issue of market definition, the Commission notes the following:

- The majority of wine sold is under $10 per bottle;
- Those that drink wine in this price range are likely be significantly less sensitive about the brand and type of wine than drinkers of more expensive wine; and,
- Wine often represents the most expensive item in a consumer's shopping trolley and thus elasticity of demand for brands (and perhaps types) could be high for consumers in this price range.

Therefore, the Commission has considered whether it would be possible that for purchasers of cheap, low quality wine, different types of wine (principally red and white) could be considered reasonable substitutes. Thus, if a hypothetical supplier of (say) white wine were to impose a small, yet significant, non-transitory increase in price, it is possible that switching by purchasers of low quality wine *could* make the price increase unprofitable. If this could be clearly demonstrated, it would imply a single wine market. The Commission has sought empirical and anecdotal information to give some indication of the amount of switching between types. However, insufficient information was available to allow reasonable estimates to be made.

Arguments for Quality Differentiated Wine Markets

71. The Commission considered defining separate markets for "premium" and "cheap" wine to reflect their very different quality levels. From a demand perspective it is clear that (say) a premium quality Marlborough Sauvignon Blanc would not closely compete with a cheap imported wine. Notwithstanding this, it is likely that the premium wine would compete with others at its price level and in the immediately adjacent price level. Therefore, if the price were to rise for this premium wine the consumer would be likely to find another Marlborough Sauvignon Blanc of very similar quality and price to be a

[10] Champagne is essentially a sparkling wine, but any sparkling wine made outside of the Champagne region in France are legally precluded from being called "Champagne".

satisfactory substitute. This overlapping substitutability between wines at adjacent quality/price levels would result in a chain of substitutability stretching from the premium wines to the cheap low quality wines. On this basis, all wines of a particular type would fall within the same product market.

72. Furthermore, selecting which wines should be considered as "premium" would be a fairly arbitrary process as there is no industry consensus as to what constitutes a premium wine. Industry sources have advised the Commission that whether a wine is considered to be premium depends very much on public perception and marketing. Although wine awards offer some indication, there is a degree of subjectivity in the judging. The quality of the vintage is also a very important factor in the quality of the wine so wine quality can change significantly from year to year.

73. Some industry participants felt there was justification for defining a separate market for cask wine. This was because cask wine was typically cheaper than other wines and it is obviously packaged differently. However, a separate market is not considered appropriate, as although it is recognised these wines are of lower quality (often bulk imported and filled in New Zealand), it is understood that wine of similar or identical quality is sold in bottles. A price rise for cask wine would thus be likely to induce significant switching to cheap bottled wine. The Commission therefore considers cask wine to form part of the chain of substitutability.

Conclusion on the Product Market

74. The Commission notes it is difficult to define precise boundaries for the relevant product markets in this case. Therefore, while recognising the possible existence of a wine market, the Commission has adopted a conservative approach, and has considered the narrower markets for each type of wine (red, white, sparkling, and fortified). This is based on the premise that if no dominance concerns exist in the narrow markets, it is unlikely they will exist in the broader wine market.

75. The Commission concludes that for the purpose of assessing competition implications of the proposed acquisition, the relevant product markets are for each of red, white, sparkling, and fortified wines, and for wine producing grapes.

Functional Market

76. As described earlier, wine goes through various stages, or functional levels, before it reaches the consumer. The functional levels are: grape growing; wine making; distributing; and retailing.

77. Most of the major winemakers use a combination of grapes grown on their own vineyards and those grown under contract by specialist grape growers. The average split between own grown and contract grown grapes for the 1999 vintage was around 66:34, but this varies depending on the variety and the preferences of the winemakers. For example, 92% of all Muller Thurgau grapes grown are contracted while the corresponding figure for Sauvignon Blanc is 43%. For winemakers, Montana contracts [ ] of its grape growing, while the corresponding figure for Corbans is [ ]. Montana and Corbans are thus both growers and purchasers of grapes, and aggregation will occur.

78. Most winemakers do not distribute their own wine but instead use specialist national liquor distributors. This avoids the need to have a national sales force of their own. Importers of wine do similarly.

79. It is noted that Montana acts as distributor for ten foreign brands and five New Zealand brands. Corbans does not act as a distributor for any brands other than its own. However, because Montana will now be distributing the Corban range of wines, aggregation has occurred at the distribution level and must therefore be considered.

80. Winemakers do not generally participate in retailing wine to any great extent. One exception is wine cellar sales, while some wineries also operate restaurants. These sales are not believed to be considered significant in terms of the overall wine market so the retail market will not be considered further.

<u>Conclusion on the Functional Market</u>

81. The Commission concludes that for the purpose of assessing competition implications of the proposed acquisition, the relevant functional markets are for grape growing, the production and importation of wine for distribution, and for the distribution of wine.

Geographical market

82. The Commission agrees with the applicant that the geographical extent of the market is nation wide. Wine is a relatively high value product compared to its freight cost, and therefore it can be economically transported. The Commission is aware of numerous examples of grapes, juice, and finished wine being transported significant distances for further processing/bottling. For example, [ ] transports its grapes from its vineyards in Hawkes Bay to its processing plant in Auckland, as does [ ]. [ ]. In addition, given that wine is commonly imported in bottled and juice form gives further indication of the ability to economically transport wine.

<u>Conclusion on the Geographic Market</u>

83. The Commission concludes that for the purpose of assessing competition implications of the proposed acquisition, the relevant geographic market is New Zealand.

Conclusion on markets

84. The Commission concludes that the relevant markets are:

- The national market for the supply of wine producing grapes;
- The national market for the importation or production of red wine for distribution;
- The national market for the importation or production of white wine for distribution;
- The national market for the importation or production of sparkling wine for distribution;
- The national market for the importation or production of fortified wine for distribution; and,
- The national market for the distribution of wine.

COMPETITION ANALYSIS

Introduction

81. The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of **dominance**.

The Dominance Test

82. Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

83. Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
>
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

84. The test for dominance has been considered by the High Court. McGechan J stated:[11]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It 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*."

85. Both McGechan J and the Court of Appeal, which approved this test,[12] stated that a lower standard than "a high degree of market control" was unacceptable.[13] The Commission has acknowledged this test:[14]

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[11] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC).
[12] *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA).
[13] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC).
and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA).
[14] *Business Acquisition Guidelines*, Section 7.

> “A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction.
>
> “A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability.” (p21)

86. The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not so satisfied, clearance must be declined. The dominance test is applied in the following section.

The market for the supply of wine producing grapes

Market Concentration

87. An examination of concentration in a market often provides a useful first indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

88. The *Business Acquisitions Guidelines* specify certain “safe harbours” which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> *“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 exist:*
> *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.” (p 17)*

89. These safe harbours recognise that both absolute levels of market share and the distribution of market shares between the merged firm and its rivals are relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state that:

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

90. Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through possible market entry, also typically need to be considered and assessed.

91. Within the market for the supply and acquisition of wine producing grapes there are a number of varieties produced, with the main ones being Sauvignon Blanc, Chardonnay, Pinot Noir, Muller Thurgau, Muscat and Cabernet Sauvignon. The largest producing regions were Marlborough (29,229 tonnes), Gisborne (22,133 tonnes) and Hawkes Bay (19, 472 tonnes). These three regions produced 89% of the total production.

92. Montana has a strategy of vineyard ownership and is a large producer of different grape varieties. In 2000, approximately [ ] of its total grape crush, came from its own vineyards. Corbans has a lower level of vineyard ownership and it relies more heavily on purchasing grapes from contracted growers. In 2000, [ ] of its total grape crush, came from its own vineyards. The market shares of the major grape producers are outlined in Table 3 below.

Table 3:

Market Shares of Grape Production for the Year 2000 (tonnes)

	Own Vineyards	*Market Share (%)*	*Contract Growers*	*Market Share (%)*	*Total*	*Market Share (%)*
Montana	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Corbans	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Nobilo	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Villa Maria	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**

Source: Data obtained from Montana, plus other competitors in market.

93. The merged entity would have approximately [ ] of the total grape production either as a grower or a purchaser. It would produce approximately [ ] of the total grape production and rely upon purchases from independent growers for the remaining [ ].

Constraint from existing competitors

94. The contractual relationship between grower and winery is generally for a 3 year rolling period. Notice is required if either party wishes to terminate the contract. There is a significant degree of flexibility in terms of price per tonne in any given year to account for fluctuations in yields. If, for example there is an unusually low yield, a higher price per tonne will be negotiated for that year (and vice versa). Prices agreed on for each grape variety are published in a schedule. If a price cannot be agreed on, there is a provision to allow the matter to go to arbitration. It is understood this very rarely happens.

95. Currently in New Zealand, land is being converted or developed into vineyards at an increasing rate. In 1999 the producing vineyard area was 8,731 hectares, and this is expected to grow to 11,187 hectares by 2002. This is an increase of approximately 30% in 3 years. The varieties which are experiencing growth in plantings are Sauvignon Blanc, Chardonnay and Pinot Noir. The distribution of this new development is diverse, and is not concentrated with any one group. All of the large wine companies are involved in developing new vineyards.

96. The increase in new plantings is not concentrated in any one region. All major regions are expected to increase their vineyard producing areas. The Marlborough region is expected to grow by 30%, the Hawkes Bay region by 25% and Gisborne by 21%.

97. Presently there is strong competition among wineries to purchase particular grape varieties. Within the Marlborough region the Sauvignon Blanc variety (42%) is very popular with strong demand also for the Chardonnay (25%) and Pinot Noir varieties (11%). There is a significant quantity of grape juice and to a lesser extent grapes, that are transported from the region to other parts of the country. Vineyard ownership is not concentrated, and because of the demand for Marlborough grapes, independent grape growers have a degree of supplier power. Demand for the grapes far exceeds supply.

98. Within the Hawkes Bay region there is good demand for the Chardonnay, Cabernet Sauvignon and Merlot varieties. Vineyard ownership is diverse and not concentrated in any one group. There is a significant quantity of grapes and juice transported around the country, particularly to Auckland for further processing

99. In the Gisborne region, there is strong demand for Chardonnay grapes and to a lesser extent, the 'bulk' varieties of Muller Thurgau and Muscat, which are used to produce lower quality wines. This region has approximately 120 growers. However, a large proportion of the grapes produced are either grown or purchased by Montana or Corbans. In 2000, approximately 7000 tonnes of Chardonnay were produced in the region, about 40% of the total national production of Chardonnay. Nationally, Montana purchased [ ] of Chardonnay and Corbans [ ] from independent growers.

100. If the merged entity attempted to exercise market power in Gisborne by reducing the price it offered to the independent growers, these growers could sell their grapes to other large wine companies capable of processing them and marketing the increased volume of wine. These grapes could be transported to Hawkes Bay or Auckland for processing, or an investment in plant and equipment could be made to process the grapes in Gisborne. This imposes constraint on the behaviour of the merged entity.

101. The Commission concludes that existing competitors are likely to offer significant constraint on the merged entity.

Constraint from Entry/Expansion

102. A business acquisition is unlikely to result in the acquisition or strengthening of dominance if there is a credible threat of market entry. Potential competition can act as a constraint on market power, and so an examination of the nature and extent of this constraint is part of the Commission's assessment of competition.

103. Entry conditions, including the nature and height of any entry barriers, must be considered before the threat of new entry, which might constrain the conduct of a merged entity, can be evaluated.

104. The main resource required to enter this market is suitable land, whilst the main competencies are skills in viticulture management. There has been a big increase in the price of land suitable for grape growing, with entry into this market being capital intensive.

Capital Costs

105. The price of land in Marlborough, suitable for vineyard development ranges between $15,000 and $30,000 per acre, depending upon the quality of the site. One hundred acres of good quality land would cost $3m and would yield on average approximately 3.8 tonnes per acre or 380 tonnes of grapes.[15]

106. The cost of developing the bare land into a vineyard is approximately $12,500 per acre. This includes the cost of land preparation and planting, plants, weed and pest control, trellis construction, training, tying, pruning and trickle irrigation.[16] The development cost for 100 acres would be $1.25m or a total cost of approximately $4.25m. An average price per tonne for grapes is $1200 and the average yield is about 4 tonnes per acre, which provides a return of about $4800 per acre, or a total return of 400 tonnes or approximately 300,000 litres.[17] A winery that produces this amount of wine is regarded as a category II producer by the Wine Institute, and would be regarded as a small to medium-sized winery.

107. The capital cost of entry are not considered a significant barrier to entry.

Access to needed input

107. Land that is suitable for vineyard development is the most important input for entry into this market. Generally the soil must be free draining, the site must be within a certain temperature range, with low rainfall during the harvest period.

108. In Marlborough, Hawkes Bay and Gisborne there are still areas of suitable land yet to be developed. The Commission has been advised by the [ ]that although premium land is becoming scarce there is still some available, although in some cases it may have to be converted from other agricultural or horticultural uses.

109. In the 10 year period to 1999, the total vine area has increased from 5,440 hectares to 10,386 hectares, an increase of 190%. During that time, the number of wineries has increased from 123 to 334, an increase of 270%. Some of the increase would be from expansion from existing wineries and grape growers, however a significant proportion would be new entrants into this grape growing market.

110. The access to suitable land for vineyard development is accordingly not considered a barrier to entering this market.

Conclusion on the Market for the supply of wine producing grapes in New Zealand

111. The merged entity would produce or have produced for it under contract approximately 39,000 tonnes of wine producing grapes. It would have a market share of about 50%. However 62% of this production would be contract production and the contracts

[15] This figure depends on the climatic conditions of each vintage and the quality of the grape produced.
[16] D Barnsley, "The Economics of Grape Growing", *Chartered Accountants Journal*, May 2000.
[17] This assumes that each tonne of grapes produces approximately 750 litres of wine.

contain pricing mechanisms and termination clauses. Furthermore, current demand for grapes is such, that these contracted suppliers could sell their production to other wineries. The next largest producer, Villa Maria**,** would have a market share of [ ].

112. The barriers to entering this market are not significant, and the threat of entry by new entrants or expansion by existing competitors would constrain the behaviour of the merged entity if it, as a net purchaser, attempted to exercise market power by reducing the market price paid to contract growers.

The National Market for the Production or Importation of White Wine for Distribution

Market Concentration

114. The main types of white wine sold on the domestic market are the varietals, Sauvignon Blanc, Chardonnay, Riesling, Semillon, and to a lesser extent Pinot Gris and Gewurztraminer. The varieties are also blended to produce a product for the market. Examples of this include Sauvignon Blanc and Semillon , Chardonnay and Semillon, and Muller Thurgau and Riesling. These blended wines are generally positioned in the lower price points of the market.

115. The market shares for the white wine market are defined below in Table 4 and are based on volume of litres sold. The Commission considered basing the market share figures on sales figures. If it had the combined entity would have had a lower market share figure, because [ ]. The Commission has estimated this difference between the two methods could be up to [ ] for some of the markets considered. The Commission, however, has taken a conservative approach and used the method that gives the combined entity the higher market share.

Table 4:

Market Shares for the National Market for Production or Importation of White Wine for Distribution

Company	**Volume (000) litres**	**Market Share (%)**
Montana	[ ]	[ ]
Corbans	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**
Nobilo	[ ]	[ ]
Villa Maria	[ ]	[ ]
Orlando Wyndham	[ ]	[ ]
Southcorp	[ ]	[ ]
Other	[ ]	[ ]
Total	**[ ]**	**[ ]**

Source: individual company figures and an estimate of the total size of the market.[18]

[18] The total market was estimated by establishing the proportion of white wine sales in the supermarket distribution channel and applying that figure to the domestic sales figure produced by the Wine Institute. An adjustment was made to account for wine sales not made through usual distribution channels.

116. The merged entity would have a market share of approximately [ ] which is outside the Commission's safe harbours. As mentioned above, however, market share is only indicative of a firms market power and other factors must be considered before a conclusion on dominance can be drawn. "Others" includes Category II and I wineries plus other distributors that import wine.

117. Nobilo and Villa Maria will be the next biggest competitor with market shares of [ ] and [ ] respectively, whilst Southcorp will have market share of [ ], and Orlando Wyndham [ ].

Constraint from Existing Competitors

118. The New Zealand market is characterised by a number of critical price points. Approximately [ ] of the market is in the under $10 per bottle or cask categories, approximately [ ] of the market is in the $10-$15 per bottle category, approximately [ ] is in the $15-$20 category, and about [ ] accounting for the over $20 category. Within each of these price points there are a significant number of competing brands.

119. The domestic market is experiencing slow growth with an annual consumption per capita of 16.1 litres.[19] Over recent years there has been a strong penetration of the domestic market by imported wines, in particular Australian wines. In the year to June 2000, imported wines accounted for around 23% of the domestic market;[20] this figure has grown steadily since 1996.

120. The Australian wines are positioned below the $10 price point. The large Australia producers, Southcorp, BRL Hardy and Orlando Wyndham have advantages of scale over the New Zealand producers which are less competitive at this price point. The larger New Zealand producers position their products in the $10-$15 price point, whilst the smaller boutique producers position their products in the $15-$20 and $20+ price point categories and compete by adding value to their product.

121. The domestic market is price driven, especially in the high volume parts of the market. The consumer's perception of value for money is an important competitive element. Branding is also an important competitive element, with producers trying to create brand awareness and brand loyalty for their products. There is a degree of brand loyalty in this market, but price is an important competitive factor. There is evidence that prices for strong brands are quite elastic, with large increases in volumes when the price is reduced.

122. The existing competitors which are likely to offer effective competition to the merged entity are the larger New Zealand producers, Nobilo's and Villa Maria, and the large Australian producers who supply this market, Southcorp, Orlando Wyndham, and Mildara. To a lesser extent the smaller category II New Zealand producers should offer some constraint in the different price points.

123. Montana and Corbans have strong brands spread over the product characteristics' space.[21] Montana supplies product under the following ranges, which are all

[19] <http://www.alcohol.org.nz/effects/factpack/available1.htm1>

[20] This figure excludes imported bulk wines some of which is re-exported.

[21] A product with specific characteristics is located at a point with the product space. Products with similar characteristics are located near one another, while products with different characteristics are located apart appealing to different consumers or different consumer tastes. The purchaser of wine might be interested in a number of elements which include dryness, fruitiness, alcohol level, brand image as well as price. See F M

differentiated by quality and price. Its white wine products have an average price of [ ].

- Montana Estate range;
- Montana Reserve range;
- Montana Varietal range;
- The *Church Road* range;
- The *Saints* range;
- The Penfolds range, *Jackman Ridge*;
- The *Wohnsiedler* range;
- The *Timara* range;
- The *Avec* range;
- The *Murray Ridge* range; and
- The *Blenheimer* and *Country* cask wines.

124. Corbans supplies the following products, which are also differentiated by quality and price. Its white wine has an average price of [ ]:

- The *Cottage Block* range;
- The *Private Bin* range;
- The *Corbans Select* range;
- The *Corbans Estate* range;
- The *Huntaway* range;
- The *Stoneleigh* range;
- The *Longridge* range;
- The *Robard & Butler* range; and
- The *Chasseur* and *River Valley* range of cask wines.

125. Southcorp is a large Australian company, which in 1999 had sales revenue of NZ$900m. It crushed 210,000 tonnes of grapes during its 2000 vintage. Its products have been in the New Zealand market since 1991, and it is [ ] Its products are predominantly positioned in the under $10 price point. Southcorp supplies the following strong brands to the market: *Penfolds*, *Lindemans*, *Seaview*, *Queen Adelaide*. Its white wines have an average price of [ ]

Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd ed, Houghton Mifflin Company, Boston, 1990) 404.

126. Orlando Wyndham is another large Australian wine company, which is owned by the French company, Groupe Pernod Riccard. During the 2000 vintage it crushed 104,000 tonnes of grapes. Its products have been supplied to the New Zealand market since 1990 when they were distributed by Corbans. In 1996, Orlando established a business unit in New Zealand and began distributing its products. Its products are positioned in the under $10 price points, and it supplies the following brands; *Jacobs Creek*, *Wyndham Estate*, *Richmond Grove* and *Orlando*. *Richmond Grove* is produced under contract from grapes grown in Marlborough. Its white wine has an average price of [ ].

127. The largest competing New Zealand producers are Nobilo and Villa Maria. Nobilo until recently were a publicly owned company. They have been purchased by the large Australian company BRL Hardy, which in the 2000 vintage crushed 218,000 tonnes. Nobilo supplies its own branded products to the market and distributes the BRL Hardy range of products. The Nobilo products are positioned across all of the price points in the market, and their brands include Nobilo Grand Reserve, the Nobilo Icon Series, the House of Nobilo range, and Fall Harvest, Fernleaf, and the White Cloud range which is positioned in the under $10 category. Nobilo also distributes the Hardy range of products and the Banrock Station range of products. These products are strong brands in New Zealand and are positioned in the under $10 price points. Its white wine has an average price of [ ].

128. Villa Maria is an established large wine producer, whose brands have been in the New Zealand market for some time. Its products are represented in each of the main price points in the market. It also supplies product under the *Esk Valley* and *Vidal's* brands. The Villa Maria range of products include the *Villa Maria Reserve* range, the *Villa Maria Cellar Selection* range, and the *Villa Maria Private Bin* range. Its white wine has an average price of [ ].

129. There are also a large number of medium sized wineries in New Zealand who supply the market through distributors. These wineries produce branded products positioned in the over $10 and over $15 price point categories. Small wineries distribute their product by selling most via cellar door and mail order.

130. There is expected to be a large global increase in the production of wine producing grapes over the next year. Unless international markets are found for this increased volume, there will be an oversupply of wine and downward pressure on prices.

<u>Conclusion on Constraint from Existing Competitors</u>

131. Presently competition in this market is intense, with the increased penetration of the Australian products driving down prices across the different price points. If the merged entity attempted to increase prices by reducing supply, these large existing competitors have the capacity to increase supply to the market. Such companies have established competencies in producing quality wine, investing in brands and distributing the product to the market. These competitors will continue to offer effective competition to the merged entity.

132. The Commission concludes that the presence in the market of the Australian firms and domestic competitors will constrain the merged entity.

Constraint from Entry/Expansion

133. For a potential entrant to compete successfully in this market, it would need to have competencies in winemaking. However, this function can be out sourced, as can sales

and marketing. The winemaking function is important, because the market demands value for money and is prepared to pay for quality. Creating a brand and investing in that brand is an important competency. Branding differentiates products, and as the range of products increases, it becomes even more important to create brand loyalty and brand recognition in the market.

134. Since 1990, the number of wineries in New Zealand has increased from 131 to 334, an increase of 250%. Most of this growth has been from small category I wineries producing less than 200,000 litres. There has also been significant growth in category II wineries. This suggests that barriers to expansion in this market are not significant. However, these wineries do not have the scale advantages of the larger New Zealand and Australian wineries and must compete on the basis of producing quality products at the higher price point parts of the market.

135. These smaller competitors have a less diverse product range. Their marketing effort in terms of advertising spread and sales force is considerably smaller, and they generally distribute their product through specialist wine distributors.

Capital Costs

136. For an entrant to offer effective competition, significant investment is required in wine making plant and equipment and in working capital to create and establish a brand and sell to the market. Generally, for every [ ] invested in the winemaking process, a further [ ] investment in working capital would be required. A medium to large scale operation would require an investment of between [ ]. Some of this will be sunk costs, but is not considered a significant barrier to entry.

Product Reputation and Promotion

137. Firms may seek a point of difference for their products by differentiating them from rival offerings. Product differentiation can be based upon physical differences in product attributes, differences in physical locations, differences in the level of service or in terms of the subjective image the goods impress on the consumers mind.[22] Established products in a market may enjoy consumer acceptance and preference because of consumer satisfaction or repeated advertising over time. Many buyers prefer the products of known or tried firms over those of new firms of which less is known. This is especially so when quality is neither apparent or cheaply sampled. An entrant may have to charge less or advertise more than incumbents.[23]

138. Evidence from the industry suggests that the prices of strong branded products are quite elastic, especially in the price points under $10, which suggests price is a competitive factor. A new entrant would face a considerable sunk cost in establishing a brand in this market. However, if it is a well-positioned quality product representing value for money, evidence from the market suggests it will gain market share. This is evidenced by the penetration and growth of the Australian brands and other imported brands. Such products now account for about 23% of the total wine market.

[22] F M Scherer and D Ross, *Industrial Market Structure and Economic Performance* (3rd ed, Houghton Mifflin Company, Boston, 1990) 571.
[23] P E Areeda, H Hovenkamp, and J L Solow, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Vol IIA, Little, Brown and Company, 1995) 68-69.

139. In addition to the imported branded products, bulk wine is also imported, packaged and sold either on the domestic market or exported. This wine is generally lower quality product, which is targeted at the lower price points of the market, either in bottles or in casks.

140. Although branding is an important competitive element in this market, the Commission does not consider it to be a significant barrier to entry.

Access to Retail Outlets

141. Over recent years the distribution channels for wine have changed with a shift from traditional liquor outlets to supermarkets. Supermarkets are a very important channel for any new entrant of reasonable scale. Currently, they account for approximately 50% of all wine sales and this statistic is growing at a reasonable rate. Traditional liquor stores account for approximately 30% of wine sales, 'on premise' sales account for a further 15% and corporate accounts account for the rest.[24]

142. Supermarkets like to stock a wide range of wine products to satisfy consumers' growing sophistication. Shelf space is an important business driver for supermarkets, which are conscious of what each square metre of shelf space returns. If a product is occupying shelf space and is not selling, then there is an opportunity cost to the business.

143. Supermarkets will purchase products which sell well, have brand awareness, are well promoted, have won awards at reputable wine shows, or received good reviews in magazines such as *Cuisine*.

144. The promotional programmes of supermarkets are another important business driver for them. Supermarkets will invite proposals from wine distributors for the promotion of their products. This may involve the wine distributors purchasing floor space for 'dump stacks' for product, or purchasing 'end stacks', situated at the end of each isle. The purchase of this space is expensive and can cost as much as [ ] during the high turnover periods like Christmas and Easter. Larger companies, distributing on a bigger scale have access to greater financial resources and can afford to spend more on promotion as long as it is economic for them to do so. Smaller wine distributors with less financial resource find it difficult to compete with these large companies for this prime promotional space. However, if they produce a quality product that is well positioned and marketed, they will create a demand for their products which the supermarkets would want to stock.

<u>Conclusion on Constraint by Potential Entry/Expansion</u>

145. Overall, therefore, the Commission concludes that potential entry and expansion on a sufficient scale would provide some competitive constraint on the merged entity.

Lets Test

146. In assessing constraints from potential entry the Commission's approach is to consider whether the entry of new participants in response to the exercise of market power is likely, sufficient in extent, timely, and sustainable (the "lets test"). However, having

[24] 'On premise' sales are sales to restaurants, cafes and hotel chains.

considered the barriers to entry and expansion, the Commission is satisfied that the lets test is met.

Countervailing Power of Purchasers

147. As discussed above, supermarkets are an important retail distribution channel for most wine distributors. There are three main supermarket groups; the Foodstuffs group, Progressive Enterprises and Woolworths. There is a concentration of purchasers, with each having high volume purchases. However the merged entity would also posses a degree of supplier power through their level of concentration.

148. There are administrative and logistical advantages for a supermarket chain to deal with one large supplier. However, if the merged entity considered raising prices the supermarkets could respond by threatening to allocate less shelf space to the merged entity's products in favour of a competitors. This is likely to place considerate constrain on any attempts by the merged entity to raise prices.

Conclusion on the National Market for the Production or Importation of White Wine for Distribution

149. In adopting a conservative approach to market definition and defining narrow markets, for the purpose of the competition analysis, the merged entity would have a market share of [ ] which is outside the Commission's safe harbour guidelines.

150. The merged entity is likely to face effective competition from existing competitors. These include the Australian distributors which are continuing to penetrate the market, and the larger New Zealand companies of Nobilo and Villa Maria.

151. The barriers to expansion in this market are not significant. This is evidenced by the large increase in the number of Category II New Zealand wineries and the increase in imported product.

152. The supermarkets are likely to exert significant countervailing power.

153. On the basis of the matter discussed above, the Commission concludes that the merged entity would not be likely to acquire or strengthen a dominant position in the national market for the production or importation of white wine for distribution.

The National Market for the Production or Importation of Red Wine for Distribution

Market Concentration

154. The main varieties of red wine sold in this market are Cabernet Sauvignon, Merlot, Shiraz, and Pinot Noir, or different blends of such varieties to satisfy different tastes and styles. The market shares of the wine distributors in this market are outlined below in Table 5:

Table 5:

Estimated Market Shares for the National Market for the Production or Importation of Red Wine for Distribution

Company	Volume (000 litres)	Market Share (%)
Montana	[ ]	[ ]
Corbans	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**
Nobilo	[ ]	[ ]
Villa Maria	[ ]	[ ]
Southcorp	[ ]	[ ]
Orlando	[ ]	[ ]
Other	[ ]	[ ]
Total	**[ ]**	**[ ]**

Source: individual company figures and an estimate of the total size of the market.[25]

155. The merged entity would have a market share of [ ] which is outside of the Commission's safe harbour guidelines. The next largest competitors would be Nobilo with a market share of [ ], Southcorp [ ] and Orlando [ ]. As mentioned above, however, market share is only indicative of a firm's market power and other factors must be considered before a conclusion on dominance can be drawn.

Constraint from Existing Competition

156. The Australian distributors supply strong brands to this market, and the market perception is that Australian red wines offer good value for money. These brands are competing across all of the significant price points. Such brands as *Banrock Station*, *Jacobs Creek*, and *Wyndham Estate*, are category drivers in their respective price points. The larger New Zealand competitors also have strong brands competing across the different price points, whilst the smaller New Zealand producers distribute strong brands in the higher price point categories.

157. The discussion on the constraint from existing competitors in the white wine market (paragraphs 118 to 132 above) is also relevant to this part of the analysis.

Constraint from Entry/Expansion

158. The entry or expansion conditions for this market are similar to those for the white wine market. These conditions are discussed in paragraphs 133 to 146 above.

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[25] The total market was estimated by establishing the proportion of white wine sales in the supermarket distribution channel and applying that figure to the domestic sales figure produced by the Wine Institute.

Countervailing Power of Purchasers

159. The countervailing power of purchasers for this market is similar to that for the white wine market. These conditions are discussed in paragraphs 147 to 148 above.

Conclusion on the National Market for the Production or Importation of Red Wine for Distribution

160. The merged entity would have a market share of [ ], whilst the next largest competitors would have market shares of [ ] and [ ]. These levels of market share are outside the Commission's safe harbour guidelines.

161. The merged entity would face effective competition from existing competitors, who would offer a significant competitive constraint to the behaviour of the merged entity. These competitors include large vertically integrated Australia distributors of wine and the larger competing New Zealand companies who would be competing with the merged entity across the product range.

162. There are no significant barriers to entering this market on a scale sufficient enough to offer effective constraint to the merged entity. With a large increase in the production of wine producing grapes predicted over the next five years, there will not be a shortage of raw material available.

163. The concentration of purchasers in the supermarket distribution channel, and the low switching costs and availability of alternative supply, provides the supermarkets with a strong degree of countervailing power.

164. On the basis of the matter discussed above, the Commission concludes that the combined entity would not be likely to acquire or strengthen a dominant position in the national market for the production or importation of red wine in New Zealand for distribution.

The National Market for the Production or Importation of Sparkling Wine for Distribution

Market Concentration

165. In the market for the production or importation of sparkling wine for distribution, the product range is broad with a number of competing brands positioned in each of the price points. The estimated market shares for this market are outlined below in Table 6.

166. The merged entity would have a market share of approximately [ ], with the next largest competitors having market shares of [ ] and [ ]. These levels of market shares are outside of the Commission's safe harbour guidelines. As mentioned above, however, market share is only indicative of a firms market power and other factors must be considered before a conclusion on dominance can be drawn.

Table 6:

Estimated Market Shares for the National Market Production or Importation of Sparkling Wine for Distribution

Company	Volume (000 litres)	Market Share (%)
Montana	[ ]	[ ]
Corbans	[ ]	[ ]
Merged Entity	**[ ]**	**[ ]**
Nobilo	[ ]	[ ]
Villa Maria	[ ]	[ ]
Southcorp	[ ]	[ ]
Orlando	[ ]	[ ]
Other	[ ]	[ ]
Total	**[ ]**	**[ ]***

Source: individual company figures and an estimate of the total size of the market.[26]

* Does not add to 100% due to rounding.

Constraint from Existing Competition

167. The merged entity would have strong brands in this market. In particular, the *Bernadino Spumante* and *Aquila* brands in the lowest price point, the *Lindauer* and *Diva* brands in the middle price points, and *Lindauer Special Reserve* and *Deutz* in the higher price points. The *Bernadino Spumante* and *Lindauer* brands are responsible for a large portion of Montana's volume in this market. There are a number of competing brands within each price point, the ones with significant volume being Nobilo *White Cloud*, Southcorp's *Queen Adelaide* and *Seaview*, and Orlando's *Jacob Creek*. "Others" is made up of independent wineries producing their own sparkling wines, for example Hunters, Morton Estate and Alan Scott, positioned in the higher price points, and also includes distributors directly importing Champagne from France.

168. The Lindauer brand is particularly strong and is priced to provide the consumer good value for money. It is often used as a "loss leader" in supermarket promotions which underpins its market share somewhat. The Commission recognises that brand loyalty can be a significant competitive advantage, other competitors, however, also have well-known reputable brands that could expand should the combined entity attempt to raise prices.

Constraint from Entry/Expansion

169. The entry and expansion conditions of this market are similar to the markets discussed above at paragraphs 133 to 146.

[26] The total market was estimated by establishing the proportion of white wine sales in the supermarket distribution channel and applying that figure to the domestic sales figure produced by the Wine Institute.

Countervailing Power of Purchasers

170. The power of purchasers in this market is the same as the markets discussed above at paragraphs 147 to 148.

Conclusion on the National Market for the Production or Importation of Sparkling Wine for Distribution

171. The merged entity would have a market share of [ ], with the next largest competitors, Nobilo and Southcorp having market shares of [ ] and [ ] respectively. These levels of market share are outside the Commission's safe harbour guidelines.

172. The Commission believes that, notwithstanding the degree of brand loyalty in respect to the merged entity's *Lindauer* brand, the market is price sensitive and the existing competitors are capable of offering effective constraint to the merged entity if it attempted to exercise market power by increasing prices or offering less in terms of product quality.

173. The countervailing power of the supermarket groups, which are a very important distribution channel for suppliers to this market, will also offer constraint on the behaviour of the merged entity.

174. On the basis of the matters discussed above, the Commission concludes that the merged entity would not be likely to acquire or strengthen a dominant position in the national market for the production or importation of sparkling wine for distribution.

National Market for the Production or Importation of Fortified Wines for Distribution

Market Concentration

175. The Commission has estimated the market shares for this market. These are set out in Table 7 below. These figures are based on those provided by the main competitors in the market to the Commission. The combined entity will have a market share of [ ] which breaches the Commission's safe harbours.

Competition Analysis

176. As noted earlier, liquor laws restrict supermarkets from selling alcohol with content greater than 16%, which precludes much of the fortified wines. It is understood that a significant proportion of Montana and Corbans' volume is in supermarkets, as they are two of the few firms that produce low-alcohol fortified wines. Other competitors have noted, however, that they could also produce a low-alcohol wine if a reasonable return was possible.

177. The market for fortified wine is understood to be in decline. For example, between 1986 and 1996 domestic sales dropped by around 70%.[27]

[27] Based on figures provided by the Wine Institute.

Table 7:

Estimated Market Share for the National Market for Production or Importation of Fortified Wines for Distribution

Company	Volume (000 litres)	Market Share (%)
Montana	[ ]	[ ]
Corbans	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**
Nobilo	[ ]	[ ]
Southcorp	[ ]	[ ]
Orlando	[ ]	[ ]
Villa Maria	[ ]	[ ]
Others	[ ]	[ ]
Total Market	**[ ]**	**[ ]***

Source: individual company figures and an estimate of the total size of the market.[28]

***Does not add to 100% due to rounding.**

178. Around 450,000 litres of fortified wine is imported, principally from Australia, although the premium wine comes from Portugal and Spain. This represents around 20% of the market. These imports are brought in either by the main competitors in the market (Montana, Corbans, Orlando, Southcorp, Nobilos) as well as liquor distributors, and other independent agents. These firms could easily increase supply if the merged entity attempted to raise prices.

Conclusion on the National Market for the Production or Importation of Fortified Wines

179. On the basis of the issues discussed above, the Commission concludes that Montana would not be likely to acquire or strengthen a dominant position in the national market for the production or importation of fortified wine for Distribution.

National Market for the Distribution of Wine

180. As noted earlier, Montana acts as a distributor for its own brands, as well as ten foreign brands, and five domestic brands. Following the acquisition, Montana will distribute Corbans brands and therefore aggregation will occur at this level.

Market Concentration

181. The market shares have been estimated in Table 8 below. The size of the distribution market was estimated by aggregating the four upstream product markets (white, red,

[28] The total market was estimated by establishing the proportion of white wine sales in the supermarket distribution channel and applying that figure to the domestic sales figure produced by the Wine Institute.

sparkling, and fortified wines). The only major difference in terms of market share is that there is greater consolidation among Category II and I brands as one distributor will typically distribute several small brands.

Table 8:

Estimated Market Share for the National Market for the Distribution of Wine

Company	Volume (000 litres)	Market Share (%)
Montana	[ ]	[ ]
Corbans	[ ]	[ ]
Sub-total	[ ]	[ ]
Others	[ ]	[ ]
Total	[ ]	100

182. Distributors will do some level of promotional work for the wine depending on its source. If the distributor has imported the wine then it will do most of the marketing. For domestic wines, however, it is predominantly up to the winemaker to create brand awareness and demand for its product.

Constraint from Current Competitors

183. There are several wine distributors of reasonable size which a winemaker may choose from. These include (among others) National Liquor Distributors, Eurowine, NZ Spirit Merchants. Existing competitors also have access to 'traditional liquor' distribution. Such businesses include Gilmours, Rattrays, Tasman Liquor, and are independent of companies associated with the merged entity.

184. The merged entity will continue to have a strong presence in 'on premise' distribution. It could leverage the increased strength of its product range, promotional budget and sales force by being able to supply restaurants, cafes and hotels with the complete wine list, and promotional programs which assist in the operation of these businesses. However, these 'on premise' channels prefer diversity in their product offerings, which provides an opportunity for competitors products. [ ] has advised the Commission that there is a lot of opportunity for medium sized wineries to "cherry-pick" on-premise locations.

185. There are a number of independent distributors which sell and promote a range of New Zealand and imported wines, and which could increase their portfolio of wines. Accordingly, the merged entity could not control distribution to the domestic market and exclude competing products.

Countervailing power of purchasers

186. The Commission has been advised that supermarkets prefer to deal with several distributors rather than just one or two. This enables the supermarkets to get better access to a range of product, and enables them to "play one off against each other".

187. A key focus of the supermarkets is maintaining margins on their products. If the merged entity were to raise prices, the supermarket's margins on those products would shrink. The supermarkets would be likely to react by allocating less shelf space to those products.

Conclusion on the National Market for the Distribution of Wine

188. The merged entity will be constrained in the market by other competitors offering a similar service. The merged entity will also be constrained in terms of supermarkets countervailing power. The Commission concludes that the combined entity is unlikely to acquire or strengthen a dominant position in the national market for the distribution of wine .

OVERALL CONCLUSION

189. The Commission has considered the likely impact of the proposal in the following markets:

- The national market for the supply of wine producing grapes;
- The national market for the importation or production of white wine for distribution;
- The national market for the importation or production of red wine for distribution;
- The national market for the importation or production of sparkling wine for distribution;
- The national market for the importation or production of fortified wine for distribution; and
- The national market for the distribution of wine.

190. Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission has concluded that implementation of the proposed acquisition, would not result or be likely to result in any person acquiring or strengthening a dominant position in any of the above mentioned markets.

DETERMINATION ON NOTICE OF CLEARANCE

191. Accordingly, pursuant to section 66(3) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Montana Group Ltd of a 100% share of Corban Wines Ltd.

Dated this 6th day of September 2000

M J Belgrave
Chair

APPENDIX A: BRANDS

Montana

Avec

Azure Bay

Bernadino

Blenheimer

Brancott Estate

Chardon

Church Road

Copperfield

Country

Deutz

Fairhall

Fricante

Hyland

II Casino

Jackman Ridge

La Pica

Lindauer

Misty Peak

Mont Royal

Montana

Ormond Estate

Patutahi Estate

Red Ridge

Renwick Estate

Riverlands

Saints

Salut

Timara

Tintero

Twin Rivers

Wohnsiedler

Agency brands

Tatichella
Babich
Murray Ridge
Schlumberger
Cordiere
Delas
Frescobaldi
Gassac Terrasses
Louis Latour
Lawsons Dry Hills
CJ Pask
Wither Hills
Chard Farm

Distributors for

Lion Nathan
NZ Wines & Spirits Brands

Corbans

Amadeus

Aquila

Bakano

Cellermans

Champernay

Chasseur

Corbans Estate

Corbans Private Bin

Corbans Select

Corbans White Label

Diva

Hallmark

Huntaway

Italiano

Liebestraum

Longridge

Montel

River Valley

Robard & Butler

St Amand

Stoneleigh

Velluto Rosso

Verde

Waimanu

APPENDIX B: SUBSIDIARIES RELEVANT TO APPLICATION.

Lion Nathan

New Zealand Wines and Spirits Holdings Ltd
Lion Liquor Retail Ltd (Liquor King)

Montana

Trading

Montana Wines Ltd
Montana Wines (Aust) Pty Ltd
Montana Wines (UK) Ltd

Non-trading

Penfolds Wines New Zealand Ltd, including subsidiaries:
- Averill Estate Ltd
- Redlock Holdings Ltd
- Woodhill Vineyards Ltd

The Wine Gallery Ltd
Ormond Wines & Vineyards & Estates Ltd

Corbans

Non-trading

Cooks New Zealand Wine Company Ltd
Huntaway Vintners Ltd
International Cellars Ltd
Longridge Wines Ltd
Riverlea Wines Ltd
Robard & Butler Ltd
Stoneleigh Vineyards Ltd
Sun Country Juices Ltd