ISSN NO. 0114-2720
J3942
M2415

Commerce Commission

Decision No. 389

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

EFG SERVICES LIMITED

and

CARTER AND ASSOCIATES (1995) LIMITED

The Commission: Paula Rebstock
Liz Coutts

Summary of Application: That EFG Services Limited acquire the assets and business operations of Carter & Associates (1995) Limited

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

Date of Determination: 3 April 2000

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS

CONTENTS

<

THE PROPOSAL

1 In a notice to the Commission dated 17 March 2000, pursuant to section 66(1) of the Commerce Act 1986 (the Act), EFG Services Limited (EFG) sought clearance to acquire the assets and business operations of Carter & Associates (1995) Limited (Carter).

THE PROCEDURES

2 The notice was received and registered on 20 March 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 ten working days, unless the Commission and the person who gave the notice agree to a longer period. Accordingly, a decision is required by 3 April 2000.

3 In the application EFG sought confidentiality for the fact of the proposal, and for the market estimates included in the application. On 22 March 2000 the applicant amended the request for fact confidentiality by proposing that two medium sized wineries [ ] could be approached in confidence. The Commission concluded that this was acceptable. A confidentiality was made in respect of the fact of the proposal until the date of determination, and on the market shares until 20 working days after determination. When the Order expires, the provisions of the Official Information Act 1982 will apply to the information.

4 Pursuant to section 105 of the Act, the Commission delegated its powers to consider and determine the notice seeking clearance to Ms Paula Rebstock and Ms Liz Coutts.

5 The Commission's determination is based on an investigation conducted by its staff. In the course of the investigation Commission staff discussed the application in confidence with the applicant, the target company, [ ] and Seifried Estate]. Some background information was obtained also from the Wine Institute of New Zealand and from the Pharmacy Guild of New Zealand, but the proposal itself was not discussed with these organisations.

THE PARTIES

EFG Services Limited

6 EFG is a non-trading company which was incorporated in New Zealand in 1987. It is ultimately 100% owned by Fosters Brewing Group Limited (Fosters), a large

Australian company which produces beer and wine. Fosters is listed on the Australian Stock Exchange.

Carter & Associates (1995) Limited

7 Carter, which is based in Auckland, distributes brewers and winemakers supplies. The business was established in 1973. The products which Carter distributes include yeast and chemicals for wine-making, filtration materials, 'capsules' for covering corks, wires for restraining corks on sparkling wine bottles, glass bottles, oak barrels, and natural and synthetic corks. It is the major supplier of corks to winemakers in New Zealand, and [ ] of its turnover derives from the sale of natural corks.

OTHER RELEVANT PARTIES

Vinpac International Pty Limited

8 Vinpac International Pty Limited (Vinpac) is also a 100% subsidiary of Fosters. Vinpac is a packaging company which supplies materials, including corks, to Australian wine producers, and which undertakes contract bottling for wine makers. It has no physical presence in New Zealand, but supplies a small part of the New Zealand market for corks from Australia.

Esvin Wine Resources Limited

9 Esvin Wine Resources Limited (Esvin) is based in Auckland and is a supplier of commercial wine making equipment. The company was incorporated in 1993.

BACKGROUND

10 This application relates to the supply of corks to wine makers.

Wine Making in New Zealand

11 Wine is produced in ten main regions in New Zealand. Since 1993 the area of land devoted to vineyards has increased substantially, as shown in the table below. The volume of wine produced each year is affected greatly by weather conditions, and by the presence or absence of diseases affecting vines

(particularly phylloxera). Wine yields are strongly influenced by the varieties of grapes which are cultivated. High yielding varieties producing non-premium wines have been substantially replaced by lower yielding varieties producing premium quality wine. The extensive plantings of recent years will take some time to come into full production

Year	Total Vine Area (hectares)	Producing Area (hectares)
1993	6,100	5,980
1994	6,680	6,110
1995	7,500	6,110
1996	7,800	6,610
1997	8,455	7,410
1998	8,930	7,580
1999	11,530	9,000

12 The number of wineries in New Zealand has increased greatly in recent years, from 131 in 1990 to 364 now. Many of these are very small. Figures from the Wine Institute of New Zealand show that only four wineries produce more than two million litres a year, with 23 producing between 200,000 and two million litres. The remaining 337 wineries produce less than 200,000 litres a year. Wine has become a noteworthy export item, and the value of wine exports rose to $125 million in 1999.

Cork and Corks

13 Cork is produced from the outer bark of the cork oak (*Quercus suber*), an evergreen tree grown in Portugal, Spain, parts of southern France and Italy, and in North Africa. Cork is first removed from cork oaks when the trees are about 25 years old, although the first crop is of low quality. The bark re-forms after removal, and new bark 2.5 to 5 centimetres thick can be removed every several years, with nine year intervals being typical, for about 150 years.

14 Cork's unique properties derive from its structure of air-filled cells which result in watertight, light and flexible objects which are impervious to liquids. Corks typically have about 40 million cells per cubic centimetres, that is, about 800 million cells in a single wine cork.

15 Cork has been used for several thousand years for a variety of purposes – as stoppers, for fishing buoys, sandals, and in buildings and ships.

16 Cork was first used as wine closure by the French monk Dom Pérignon in the 17th century. The use of cork for this purpose increased as mass-produced glass bottles became more widely used. The first cork stopper factory opened in about 1750, in Anguine, Spain. By 1930 Portugal had become the world's leading cork producer, and it has maintained this position.

MARKET DEFINITION

Introduction

17 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, and in which the application of section 47(1) of the Act can be examined.

18 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."

19 Principles of market definition are contained in *Telecom Corporation of New Zealand Ltd v Commerce Commission*[1], and in the Commission's *Business Acquisition Guidelines*[2] (the Guidelines). An outline of these principles follows.

20 Markets have three dimensions: product type, geographical extent and functional level. A market includes products which 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 there is an incentive to do so because of a change in relative prices. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. Within this space, a hypothetical, profit-maximising, monopoly supplier could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

21 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

---

[1] (1991) 4 TCLR 473

[2] Commerce Commission, Business Acquisition Guidelines, 1999, pp 11 - 16

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.

22 Markets are also defined by functional level, which is a necessary element in the definition of relevant markets. Typically, production, distribution and sale occurs through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next.

The Relevant Markets

23 The applicant has defined the relevant market as "the supply of natural corks and other bottle stoppers to purchasers in New Zealand". While Carter distributes other materials used by wineries, there is no aggregation in respect of those materials, and they are not considered further.

Uses for corks

24 For almost all of the wine which is bottled in New Zealand natural corks are used as stoppers. Although some wine is sold in casks and in bulk, the demand for wine packed in these ways is reducing. According to the Wine Institute of New Zealand, 60 to 70% of New Zealand wine was sold in casks in the early 1980's, but this has fallen to about 30% now. The trend to glass is expected to continue. The reasons include the superiority of glass for maintaining wine quality, and the availability of good quality wine in bottles at relatively low prices. This trend is not confined to New Zealand.

25 Traditionally corks were used as stoppers for some other purposes, such as by pharmacists. However, the use of metal screw tops and tops with safety features (such as 'child-resistant" caps) is now the norm in these fields. A representative of the Pharmacy Guild said that she did not know of any current use of corks by pharmacists.

Activities of Distributors

26 Distributors import corks in bales, and prepare them for sale. The preparation includes treatment by paraffin and silicone to allow the corks to be slid readily into bottles. The distributors grade the corks, normally into three categories. Where the buyer requires its name or logo on the corks, the distributor applies these with a printing machine, or in some cases by burning the details on. The corks are then packed in plastic bags containing 1,000 corks. Sulphur dioxide is injected into the bags as a sterilant. As plastic bags are semi-permeable, the

protection given by the sulphur dioxide diminishes with time, and distributors generally recommend that corks be used within six months of purchase. [ ] said that his policy is not to use corks which werepacked more than three months previously. Storage conditions are likely to affect the shelf life of corks.

27 The range of corks sold is small. Carter offers straight corks in three lengths, and in three standards quality grades. There is also a much more expensive premium line which is sold in small quantities. Longer corks are preferred for higher quality wine. Cork quality features include the size of the lenticels (pores), with smaller lenticels being associated with higher quality. The presence or absence of imperfections, that is, cosmetic features, are also elements of the quality grading. One type of cork for sparkling wine is offered by Carter.

28 Distributors of corks supply their products throughout New Zealand.

29 As noted above, there are now over 360 wineries in New Zealand, with 92% of these being classified as small (producing less than 200,000 litres a year). Only the large and medium sized wineries bottle their own wine, with the smaller firms using contract bottlers. It is usual for wineries to buy their own corks, even where contract bottlers are used. Contract bottlers generally carry a relatively small stock of corks for use in situations such as where a winery produced a larger quantity than it had expected and for which it had insufficient corks. The reasons that wineries obtain their own corks include their wish to have them branded with their logos, their view that they may obtain better prices by buying direct from the distributors, and the wish to maintain control over the quality of packing materials.

Substitutes for natural cork

30 Some wineries in New Zealand are using synthetic corks, which are considerably cheaper than natural cork. Synthetic corks are available at 13.5 cents each, which is about half the price of natural cork. Most natural corks used are of 'No 1 grade' (the lowest of the three main quality grades) and are typically priced from about 26 to 29 cents each. The next grade ('Supers') can be about 10 cents per cork more, while the top grade ('Extra') is a further several cents more expensive at 40 to 50 cents each. Very small quantities of a premium line are sold at about 60 cents each. Premium corks have a superior appearance, and are thought to be preferable if wine is to be aged for an extended period. Large buyers may obtain quantity discounts.

31 [ ] pointed out that because cork is a natural material, it can vary considerably and the grades are not precisely defined. A continuing problem with natural cork is the risk of tainting, because of contamination by chemicals in the cork and by the development of microorganisms, resulting in a defect called "corked wine". Corking is caused by a contaminant 2,4,6-trichloroanisole (TCA)

which can spoil the taste of the wine, or even cause it to be mouldy. Estimates of such quality problems caused by defective corks range from 1% to 8% of all bottled wine[3].

32 Further research on synthetic corks is being undertaken abroad, and the view of *The Economist* is that they (and metal caps) will gain an increasing share of the global market[4]. There is still caution in their use in New Zealand. Both [ ] and [ ] said that they had conducted trials with the use of synthetic corks, but had concluded that they were less satisfactory than natural corks, and do not intend to use them in the near future. In contrast to prices in New Zealand, *The Economist*[5] stated that synthetic corks are not cheaper than natural cork, but that wineries are increasingly interested in them because of a search for more consistent quality.,

33 Metal screw caps are technically effective for many types of wine, and are used in small quantities by some New Zealand wineries. [ ] described them as "ideal" for wine which is to be consumed relatively soon after bottling. However, they might not perform as well when the wine is stored for a lengthy period. Metal caps are used to some extent in Germany, while in the United States they are used for cheaper wines. In Switzerland they are used for even top quality wines. Wineries in New Zealand appear to consider that consumers here would be reluctant to accept them. This appears to be partly because pulling the cork on a wine bottle is considered to add to the atmosphere of occasions on which wine is served, and possibly because of consumer perceptions of what packaging features indicate quality.

Conclusion on the Relevant Markets

33 The Commission concludes that the relevant market is that for the supply of stoppers for wine bottles in New Zealand.

COMPETITION ANALYSIS

Introduction

34 Section 47(1) of the Act provides that:

> "no person shall acquire assets of a business or shares, if, as a result of the acquisition, -

---

3 *The Economist*, 5 June 1999, "A Corking Row", p 92
4 *The Economist*, 5 June 1999
5 *The Economist*, 5 June 1999

(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."

35 Section 3(9) of the Act states that:

"For the purposes of sections 47 and 48 of this Act, a person has, or 2 or more persons that are interconnected or associated together have, as the case may be, a dominant position in a market if that person as a supplier or acquirer, or those persons as suppliers or acquirers, of goods or 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…"

36 Section 3(9) also states that a determination of dominance shall have regard 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, or those persons are, constrained by the conduct of competitors or potential competitors in that market:

c) The extent to which that person is, or those persons are, constrained by the conduct of suppliers or acquirers of goods or services in that market."

37 In the Commission's view, as expressed in its *Business Acquisitions Guidelines 1999* (page 17), 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; or

- 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.

38 The test for dominance has been considered by the Hight Court. McGechan J stated[6]:

"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*."

This test was approved by the Court of Appeal.

---

6 *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103, 762 103, 787 (HC)

39 The Commission acknowledged this test in its *Business Acquisition Guidelines 1999,* where it stated that:

> "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."[7]

40 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 a 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 satisfied, clearance is declined. This test is applied in the following analysis.

The market for the supply of stoppers for wine bottles in New Zealand

41 In considering whether the proposed acquisition might lead to the acquiring or strengthening of a dominant position in a market, the Commission examines the extent of rivalry within the market, and the constraint provided by the threat of new entrant. There may also be some constraint in the form of countervailing market power in the hands of customers or suppliers.

Existing Competition

Market Concentration

42 An examination of market concentration may give a useful first view of whether a merged firm may be constrained by other participants, and thus on the extent to which it may be able to exercise market power.

43 In examining market concentration, the Commission has developed a set of 'safe harbours'. These are outlined in the Commission's *Business Acquisition Guidelines*. The safe harbours recognise the importance of both the absolute levels of market share, and the distribution of market shares between the merged entity and its competitors in determining the extent to which rivals are able to constrain the behaviour of the merged firm.

44 If a proposed acquisition falls within these safe harbours, the Commission will usually grant approval. If the acquisition falls outside them, the Commission will consider a range of additional factors before drawing conclusions on market dominance.

---

[7] *Business Acquisition Guidelines 1999*, p 21

45 The applicant provided the following estimates of market shares:

Supplier	%
Carter	[ ]
Esvin Wine Resources	[ ]
Vinpac	[ ]
Total	100

46 The distribution of market shares was discussed with [ ]and [ ], and with Carter. The wineries agreed that Carter is the major supplier, but did not have more detailed market figures. Figures on the number of bottles of wine produced in New Zealand are not publicly available. However figures are available on the volume of wine produced, and there are estimates of the proportions which are sold in casks and in bottles . This information provides a good basis for estimating market shares. On the basis of their discussions, Commission staff consider that the applicant's estimates are reasonable. It is possible that the figures could overstate the shares of the major companies to a small extent, because they do not allow for direct imports by wineries. No figures are available on direct imports, but they appear to be small, perhaps 5% of the total.

47 The market shares are therefore outside the Commission's safe harbours. However, the increase which would result from the proposal is small, and EFG's interconnected company Vinpac does not have an existing New Zealand presence, but operates from Australia.

Constraint from existing competition

48 Long term supply contracts do not appear to be a feature of this market, and it is not uncommon for wineries to switch suppliers, or to buy from more than one supplier. The reasons for switching are primarily problems with quality and price competition.

49 Market shares have changed, and Carter's share was higher in the past, at about [ ] several years ago. The reduction in market share was attributed to price competition from Esvin Wine Resources, and, to a lesser extent, by the development of direct imports by wineries.

50 Direct purchases from cork manufacturers in Portugal or elsewhere are part of current supply for some wineries, and could be undertaken by other wineries. Both [ ] and [ ] have imported corks recently.

51 EFG's interconnected company, Vinpac, is itself an offshore supplier, with a small market share.

Conclusion on constraint from existing competition

52 The major existing competitor to the parties to the proposal, Esvin Wine Resources, has a reasonably substantial place in the market with a share of [ ]. It appears to be an effective competitor, which has increased its market share.

Constraint from alternative materials

53 As outlined above, it is possible that synthetic corks and metal caps could become more important in New Zealand in future. The extent to which this will occur will require further improvements in synthetic corks, and a change in consumer attitudes to wine bottle stoppers of materials other than natural cork. It is therefore difficult to give a specific weight to the effect alternative materials will have on suppliers of corks. However, as Carters already supplies a range of stoppers, it would be in a position to change its pattern of supply should buyer attitudes change.

Conditions of Entry

54 In the Commission's view, a business acquisition is unlikely to result in a dominant position in a market if the threat of new entrants acts as a significant constraint on behaviour in that market. An assessment of the nature and extent of that constraint represents a key element of the Commission's assessment of competition and market dominance. Evaluation of the weight to be given to the possibility of new entry requires assessing the conditions of entry, and identifying any barriers to entry. If these barriers are high in aggregate, the likelihood of new entry is diminished.

55 In making an assessment of the constraint from market 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. In the following analysis, entry is considered in terms of a distributor setting up an operation in New Zealand, although direct imports by wineries from overseas producers also continue to be feasible.

Likelihood and Sustainability of Entry

56 In order to be an effective constraint on incumbent market participants, entry into relevant market must be considered likely on commercial grounds.

57 Corks are produced by over 150 manufacturers in Portugal, and by others elsewhere in Europe. ([ ] imports from a French producer.) Carter buys corks from four producers in Portugal, while Vinpac has two suppliers there. As the number of producers not represented in New Zealand is large, a new distributor here would have many possible sources of supply.

58 Acquiring the capacity to undertake final processing of corks would require relatively small capital expenditure. The plant required to operate on the scale of Carter would cost up to about [ ], although the use of second-hand plant could reduce this cost. The principal items of plant are a cork treatment machine, a grading table, branding equipment, a printer, a compressor for gases, a dust collector and a vacuum bag sealing unit.

59 The quantity of corks required in New Zealand has increased considerably over the past several years, as a result of both the increase in the quantity of wine produced, and, more importantly, because of the increase in the percentage of wine which is bottled rather than being packed in casks. The continuing growth in the total vineyard area in New Zealand is likely to lead to greater wine production, thereby creating more commercial opportunities for suppliers of corks or other stoppers.

60 On the basis of the information received, the Commission has concluded that entry on a significant scale is both likely and sustainable.

Extent of Entry

61 If entry is to constrain an otherwise dominant firm, then entry must potentially be on a scale sufficient to impact considerably on its behaviour.

62 In the Commission's view, new entry could be achieved on a scale sufficiently large to constrain the merged company, given the increasing scope provided by such factors as an increased demand for wine in bottles.

Timeliness of Entry

63 To effectively constrain the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent.

64 Given that corks are imported in a largely finished form, and that the capital equipment required for final processing and packing could be obtained readily, there is nothing to suggest that the lead-in time to enter the market would be other than relatively short. The Commission considers that entry could be achieved in a timely manner.

Conclusion on Constraints from Market Entry

65 Having regard to the above factors, the Commission concludes that any new entry into the market for the supply of stoppers for wine bottles in New Zealand is

likely to be of a sufficient scale to act as an effective constraint on the merged company.

Constraint from the Countervailing Power of Buyers

66 For the relatively small number of large and medium sized wineries, who collectively account for most of the wine produced in New Zealand, direct imports of corks are feasible. While wineries would prefer to buy from local distributors, other things being equal, direct imports are feasible. Although those outside the industry might assume that the cost of corks is insignificant, this is not the case. For a hypothetical medium sized winery which bottles 1 million litres a year, the corks would cost about $370,000. A large winery could spend several times this sum. These amounts are certainly large enough for wineries to give serious attention to alternatives, if the price or quality of the products offered by distributors was unsatisfactory. While no figures are available on the total value of corks sold, the total could be about $14 million, on the assumption that 70% of wine produced in New Zealand is bottled.

67 The Commission concludes that the countervailing power of buyers would constrain the merged company from exerting market power.

OVERALL CONCLUSION

68 The Commission has considered the likely impact of the proposal on the market for the supply of stoppers for wine bottles in New Zealand. Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring of strengthening a dominant position in that market.

DETERMINATION ON NOTICE OF CLEARANCE

69 Accordingly, pursuant to section 66(3)(a) of the Act, the Commission determines to give clearance for the proposed acquisition by EFG Services Limited of the assets and business operations of Carter & Associates (1995) Limited.

Dated this 3rd day of April 2000

Paula Rebstock
Member