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COMMERCE COMMISSION

Decision No. 372

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

Spotless Services (NZ) Limited

and

P&O Services (NZ) Limited

The Commission:

M N Berry
E M Coutts

**Summary of
Proposed Acquisition:**

The acquisition by Spotless Services (NZ) Limited of all of the shareholding in P&O Services (NZ) Limited.

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:

9 September 1999

**CONFIDENTIAL MATERIAL IN THIS REPORT IS
CONTAINED IN SQUARE BRACKETS []**

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THE PROPOSAL

- 1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Spotless Services (NZ) Limited (SSL) gave notice to the Commission dated 25 August 1999 (the application) seeking clearance for it to acquire all of the shares in P&O Catering and Services (NZ) Limited (P&O).

THE PROCEDURES

- 2 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. No extension was sought by either party. Accordingly, a decision on the application is required by 9 September 1999.
- 3 Pursuant to section 105 of the Act, the Commission delegated its powers to consider and determine the notice seeking clearance to Mr Mark Berry, Deputy Chairman, and Ms Liz Coutts, Member, of the Commission.
- 4 SSL sought confidentiality for certain information contained in the application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the application. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.
- 5 The Commission's determination is based on an investigation conducted by its staff and their subsequent advice to the Commission.
- 6 In the course of their investigation of the proposed acquisition, Commission staff have discussed the application with a number of parties. These parties included institutional caterers, commercial caterers, and purchasers of catering services.

THE PARTIES

Spotless Services (NZ) Limited (SSL)

- 7 SSL is a wholly owned subsidiary of Spotless Services Limited, a company incorporated in Australia.
- 8 SSL supplies catering services to a variety of institutional and commercial customers in New Zealand including hospitals, corporates, educational institutions, and for "one-off" events.
- 9 SSL also provides other services including cleaning and engineering, ground maintenance, distribution, linen, orderly and portering services.

P&O Services (NZ) Limited (P&O)

- 10 P&O is a wholly owned subsidiary of P&O Services Pty Ltd, which is a wholly owned subsidiary of P&O Australia Limited.
- 11 P&O supplies catering, cleaning, engineering maintenance, portering, and other similar services to institutional and commercial customers in New Zealand, including educational and healthcare institutions.

BACKGROUND

Catering Services

- 12 Commercial catering services encompass the provision of food and beverage services for “one-off” events such as weddings, corporate functions, and conventions. There are a large number of providers of these general catering services, ranging in size from small, one-person operations, to large commercial caterers. Catering is also provided at large “attendance” venues such as sports venues, shopping malls, and airports. The providers of services at these venues tend to be mid-size to large caterers, or operators referred to as “food and beverage retail managers”.
- 13 There are also catering services provided to institutions such as hospitals, rest homes, prisons, university halls of residence, and boarding schools. Typically, the institutions themselves will provide the kitchen facilities, and the caterer will provide the staff, foodstuffs and beverage requirements.

Support Services

- 14 SSL notes in the application that both it and P&O are involved in other services such as cleaning, laundry services, maintenance and portering services. These are “support” services usually associated with the general running of an institution. In some instances, an operator may have a contract to provide all such services at an institution, while in other cases, there may be a number of providers performing different services.
- 15 SSL submitted that there was no significant overlap between itself and P&O, with regard to these support services. With regard to general cleaning services, for example, SSL estimated that the annual national turnover would be approximately \$500 million. Of this, SSL estimated that P&O would provide approximately [] in hospitals (cleaning and orderly services), and an additional [] in general cleaning. SSL advised that it does not do general cleaning, only providing cleaning and orderly services as a part of its hospital contracts. SSL advised that its annual turnover for cleaning and orderly services is approximately [].
- 16 Further, SSL has advised that it has an annual turnover of approximately [] from building and engineering maintenance. SSL advised that P&O has little involvement in the provision of engineering services. There is no significant overlap, as submitted by SSL, in any other service.
- 17 The Commission notes that these support services are generally considered to be competitive, and the markets are characterised by numerous operators, with low barriers to entry and expansion. The relatively minor aggregation in some markets, following the proposed merger, is unlikely to result in dominance concerns.
- 18 Given these factors, the Commission proposes not to consider these “support services” further, other than to note that some aggregation is likely to result. However, any aggregation is unlikely to alter the competitive nature of these markets to any significant extent.
- 19 The Commission will therefore focus its analysis in this application upon the provision of catering services only.

THE MARKET

Introduction

- 20 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.
- 21 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.”
- 22 Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*¹ and in the Commission’s *Business Acquisition Guidelines* (“the Guidelines”)². A brief discussion of the methodology follows.
- 23 Markets are defined in relation to product type, geographical extent, and functional level. 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, in response to a change in relative prices of the products concerned. A market is the smallest area in which all such substitution possibilities are encompassed. It is in this area that a hypothetical monopoly supplier could exert market power.
- 24 A properly defined market will include products which are regarded by buyers or sellers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension). A market defined in these terms is one within which a hypothetical profit-maximising sole supplier of a product could impose at least a small yet significant and non-transitory increase in price (the “*ssnip*” test), assuming other terms of sale remain unchanged. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, or offer their product to alternative acquirers.
- 25 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of vertical functional levels, so the functional levels affected by the application have 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”.

Product/Function

- 26 The Commission has previously considered market definition in the catering industry, however in respect of a distinguishable niche market area. In Decision 284 (PRI Flight Catering/Air New Zealand)³, the Commission concluded that in-flight catering services constituted a separate market due to a number of factors which differentiated that service from other catering. The Commission continues to regard this distinction as appropriate.

¹(1991)4 TCLR 473.

²Commerce Commission, *Business Acquisition Guidelines*, 1999, 11-16.

³Decision 284, *PRI Flight Catering Limited/Air New Zealand*, 12 March 1997.

The current application requires an assessment of commercial catering services, and the provision of catering services to institutions.

- 27 Commercial catering services are provided by a range of operators including caterers, bakeries, cafes, as well as hotels and function centres. Generally, commercial caterers provide services for “one-off” events such as weddings, corporate functions, and sports events.
- 28 Institutional catering services refer to the regular provision of meals and beverages to a particular institution. These institutions include hospitals, rest homes, boarding schools, prisons, and halls of residence. The institutions, as purchasers of catering services, generally seek a service that provides for the drawing up of menus, the purchase of all foodstuffs and beverages, and the preparation and provision of meals at the institution. In some instances, such as for hospitals and rest homes, the institution itself may stipulate the menu requirements.
- 29 For many large institutional catering contracts, such as hospitals, the term of contract is generally three years. These contracts include termination clauses for poor performance. For smaller institutional catering contracts, such as rest homes and boarding schools, the term of contract may be on a monthly or three-monthly basis, again with termination clauses for poor quality food or service.
- 30 From a demand perspective, institutions seek the daily provision of agreed meals, usually prepared for a large group of consumers. In general therefore, “one off” catering services are unlikely to be a substitute, and many commercial caterers do not involve themselves in institutional catering. Further, it is noted that a large number of institutions self-cater, providing their own food and beverage requirements. These institutions do not generally offer commercial catering services, nor do they cater for other institutions.
- 31 The Commission received conflicting views on whether hospital catering should properly be included within the institutional catering market. Some industry parties commented that they believed that hospital catering was sufficiently distinct from general institutional catering, such that it formed its own market. Primary among the reasons given were the requirement for special meals to be prepared, and the large number and regularity of meals required.
- 32 Other parties commented that hospital catering could be properly regarded within the market for institutional catering market. In general, the dietary requirements of hospital patients were not considered to be so specialised that a competent, well resourced caterer could not meet such requirements. It was noted by some sources that a number of smaller caterers have been successful in catering for rest homes and private hospitals, that may have between 50-150 beds. It was submitted that these caterers could tender for the larger hospital contracts, and expand their operation accordingly. It was not considered that there are such distinguishing factors in the provision of hospital catering services that would prevent a medium sized to large sized commercial caterer from effectively competing for hospital contracts.
- 33 The Commission recognises that it may be difficult to define precise boundaries for the market. However in this case it intends to adopt a pragmatic approach using the information it has collected from several industry participants. The information received suggests that a hospital catering market may be artificially narrow. The Commission notes that some institutional caterers have major hospital contracts in addition to other institutional catering work, and that these caterers consider hospital catering as a form of

institutional catering. For the reasons outlined above the Commission considers that hospital catering does not have specific characteristics, such that it should not be considered within an institutional catering market. In particular, the need to cater for varied dietary requirements in hospitals is not a rigid barrier.

- 34 Therefore, for the purposes of assessing this application, the Commission proposes to include hospital catering services within the institutional catering market.

Geographic Market

- 35 The major providers of institutional catering services operate nationally, either through their own organisations, or through the purchase of catering services outside of the regions where they are based. In addition, a number of mid-sized caterers similarly provide catering services within, and outside, their immediate regions. The institutions themselves purchase catering services from caterers who operate outside of the institution's region.
- 36 The presence of a number of major operators, and the ability of mid-size operators to offer services in other areas suggest that a national market is the appropriate geographic boundary within which to assess the application.

Conclusion on Market Definition

- 37 The Commission concludes that the relevant market for consideration of this application is the national market for institutional catering.

ASSESSMENT OF DOMINANCE

Competition Analysis Overview

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

- 39 Section 3(9) of the Act states that a person is in a "dominant position" if:

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

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

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

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

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

42 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 share⁴.

43 However, as Tipping J stated in the High Court decision of *New Zealand Magic Millions Limited & Anor v Wrightson Bloodstock Limited* (1990) 3 NZBLC 99-175:

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

44 Accordingly, before a conclusion on dominance is reached, it is necessary to consider all factors listed in section 3(9) and any other relevant factors.

The National Institutional Catering Market

45 SSL has provided estimates of market share, based upon its knowledge and experience of the industry. SSL advised that its turnover is [] in institutional catering, and that P&O has approximately [] annual turnover. The overall value of the institutional catering market is estimated by SSL at \$800 million annually.

46 Other industry sources did not estimate the overall value of the institutional catering market, though it is also noted that no party disputed the figure estimated by SSL. The Restaurant Association of New Zealand commented that, with regard to institutional catering, it estimated SSL to have a market share of [], and P&O to have [].

47 In cases such as the present it is difficult to precisely define market shares. That being the case, the Commission will not consider market shares further, but attaches particular weight in this application to the level of constraint provided by existing and potential competitors, and any countervailing power held by purchasers of institutional catering services.

Constraint by Existing Competition

48 SSL submits that the combined entity would continue to be constrained by the conduct of existing competitors. SSL lists a number of multi-national competitors, including Eurest, Gardner Merchant, Host Marriott and Delaware North Corporation, as examples

⁴ supra, note 2, p 17.

of well resourced and experienced institutional caterers currently operating in the New Zealand market. SSL submits further that a number of medium sized catering firms could also supply the institutional catering market.

- 49 SSL also points to a number of large institutions that self-cater, and submits that the option to self-cater provides a constraint upon the behaviour of the merged entity. SSL estimates that 70-80% of institutions self cater.
- 50 Eurest is a significant competitor in the institutional catering market. Eurest advised that its annual turnover was approximately [], and it currently holds approximately [] contracts nationwide. Of these, approximately [] are in the health sector, including catering services for [] Eurest also provides catering services for rest homes, boarding schools and halls of residence.
- 51 Host Marriott, with operations at Auckland and Christchurch airports, advised that it is a “food and beverage retail manager” in New Zealand, and is not involved in institutional catering. Serco Gardner Merchant NZ Limited (SGM) provides catering services at a number of sites, including Woodbourne airbase at Blenheim, and Massey University. [

] The Commission notes that mid-sized caterers, such as The Company Catering Company (Auckland), and Quality Chef’s Service (Christchurch), also provide institutional catering services.

- 52 The Commission understands that a large number of institutions do self-cater. A number of examples were also given of institutions that originally self-catered, then out-sourced the work, then reverted back to self-catering. Examples were also given of institutions that sought expressions of interest for catering, considered these against their own in-house catering service, and decided to remain self-catering. A number of parties commented that an institution had an “advantage” over outside caterers in that it was likely to “know its business” better than a contracted caterer. On balance, the ability of institutions to self-cater is likely to continue to provide an effective constraint upon the merged entity.
- 53 The Commission considers that, if the proposal were to proceed, there would be an effective constraint provided by existing competitors on the combined entity.

Constraint by Potential Competition

- 54 SSL submits that there are few barriers to entry into this market and, consequently, that the combined entity will be effectively constrained by the threat of potential entry. SSL submits that de novo entry would require capital of no more than \$200,000 to effectively support a tender for a commercial or institutional contract. With regard to hospital contracts, SSL submits that there are no specialised services or equipment required, beyond those generally needed for an institutional catering contract.
- 55 The Commission considers that barriers to entry are not onerous. A number of mid-size and large caterers operate their own kitchen facilities, and employ nutritionists, chefs, and service staff. All industry parties commented that these operators are likely to have the necessary facilities, experience and staff resources to enter the institutional catering market. Some parties suggested that the smaller caterer could also offer institutional catering services, particularly in the provision of services to smaller hospitals, rest homes, and boarding schools. These smaller institutions were seen by many industry participants as a “stepping stone” into the larger institutions, and subsequent expansion by the caterer.

- 56 A number of commercial caterers advised that they have not entered the institutional catering market, as they do not consider that their “product” is appropriate for institutional catering. That is, these caterers employ well qualified chefs, who produce a quality food service. Institutional catering, on the other hand, is regarded by many caterers as “mass” catering, with little scope for creative expression. For that reason, these caterers have not entered the institutional catering market (notwithstanding that, on occasion, they have been invited to cater for institutions in the past). However, these caterers also recognised that they could easily expand into institutional catering, if they considered it was advantageous to do so.
- 57 A number of industry parties commented that entry from overseas operators could be effected quickly, and at a relatively low cost. It was generally considered that entry into the New Zealand market, if it occurs, is likely to follow entry into the Australian market.
- 58 Given these factors, the Commission considers that potential entry to, and expansion within, the market by a new operator would act as a constraint on the combined entity.

Constraint by Acquirers

- 59 SSL submits that the merged entity will be subject to a degree of constraint from purchasers of institutional catering services. SSL submits that many of these purchasers are large, commercially astute operations. In particular, it is contended by SSL that many of these institutions are state funded bodies, that are sensitive to any price movement in the supply of ancillary services (such as catering).
- 60 Industry participants supported this view. The Commission understands that many catering contracts (other than large hospital contracts) are terminable upon one to three months notice. A number of these smaller contracts are in fact month by month contracts. The contracts contain standard performance terms requiring the provision of food and beverage services to an assigned quality standard. Given these circumstances, the caterers acknowledge that there is a high expectation that they will provide a high quality service, at the lowest possible price.
- 61 It is therefore a characteristic of this market that the cost to the customer of switching between competitors is low, and that customer loyalty is limited to a caterer’s ability to meet service and price expectations. That is, it is a feature of the market that purchasers compare the services and value offered by different operators. In these circumstances, any attempt by the merged entity to increase prices or lower service levels is likely to result in the purchaser opting for other caterers that can provide catering services of the required price and quality standards. The Commission also notes the ability of institutions to self-cater. As discussed earlier, self-catering is a very real option for institutions, particularly if price or quality standards are not met.
- 62 The Commission concludes that the countervailing power of the institutions is significant, and that they will continue to exercise an effective constraint on the conduct of the combined entity in the post-acquisition market.

Conclusion on Dominance in the National Institutional Catering Market

- 63 The proposed acquisition is likely to result in some aggregation of market share in the national institutional catering market. However, the combined entity is likely to be constrained by the presence of a number of existing local and national operators.
- 64 Further, entry barriers are not onerous and are unlikely to represent a major barrier to any prospective entrant wishing to enter the market, or to existing participants seeking to expand their operations. The Commission also considers that there is a degree of countervailing power held by the purchasers of institutional catering services, including the ability to self-cater, such that the combined entity will be effectively constrained post-acquisition.
- 65 Given these factors, it is concluded that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

OVERALL CONCLUSION

- 66 The Commission has considered the impact of the proposal in the national market for institutional catering services.
- 67 Having regard to the factors set out in section 3(9) of the Commerce Act and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

- 68 Accordingly, pursuant to section 66(3) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Spotless Services (NZ) Limited of all the shares in P&O Services (NZ) Limited.

Dated this 9th day of September 1999

M N Berry
Deputy Chairman

E M Coutts
Member

NOTE: The target company was originally advised as P&O Catering and Services (NZ) Limited. The Commission made its determination on that basis.

The Commission has subsequently become aware that the correct name for the target company is P&O Services (NZ) Limited. The Commission's records have been amended accordingly.

The target company in the application is P&O Services (NZ) Limited.

Dated: 1 March 2000