

**Commerce Act 1986: Business Acquisition
Section 66: Notice Seeking Clearance**

Date: 30 July 2004

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
PO Box 2351
Wellington

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

Part I: Transaction Details: To be Completed by all Applicants

1 What is the business acquisition for which clearance is sought?

- 1.1 ABF Overseas Limited (“**ABF**”) seeks clearance of the proposed acquisition of the yeast business of Burns, Philp & Company Limited Group (“**BP**”) in New Zealand. ABF is (indirectly) a wholly-owned subsidiary of Associated British Foods plc (“**ABF plc**”).
- 1.2 ABF will acquire 100% of the shares of New Zealand Food Industries Limited (“**NZFI**”). NZFI is involved in the manufacture of fresh and specialty dry yeast products, sauces and dressings. The proposed acquisition is part of a global acquisition that will have the effect of transferring to ABF the international yeast, bakery ingredients and US herbs and spices businesses of BP (“**the Acquisition**”).
- 1.3 The Acquisition does not involve BP’s milling and baking businesses (Goodman Fielder).
- 1.4 George Weston Foods (NZ) Limited (“**GWF**”) is an interconnected body corporate of ABF under the Commerce Act 1986. GWF is involved in the manufacture and supply of, among other things, flour, bread and related ingredients.
- 1.5 The Acquisition is conditional, among other things, on ABF obtaining a clearance from the Commerce Commission (“**the Commission**”).

2 The Person Giving Notice

- 2.1 This notice is given by ABF. ABF requests that all correspondence and notices in respect of this application be directed in the first instance to:

Kensington Swan
18 Viaduct Harbour Avenue
Private Bag 92 101
Auckland
Attention: Rob Noakes/David Moorman
E-mail:
rob.noakes@kensingtonswan.com/david.moorman@kensingtonswan.com
Telephone: (09) 379 4196
Facsimile: (09) 309 4276

3 Confidentiality

- 3.1 Confidentiality is not sought for the fact of the Acquisition.
- 3.2 Confidentiality is sought for information contained in square brackets in this notice for the earlier of a period of two years from the date of this application or until ABF advises the Commission that it may disclose the information.
- 3.3 The information in [square brackets] and marked “Confidential” in the margin (not only in the application itself but also the attachments and CRA report) is commercially sensitive and valuable information that is confidential to ABF (and GWF) (or to BP/NZFI since various information has necessarily been made available to the applicant on a confidential basis for the purposes of preparing this application). Disclosure of that information could result in material financial loss and prejudice to the competitive position of ABF and its interconnected bodies corporate. ABF relies on s 9(2)(b) of the Official Information Act 1982. The foregoing applies equally to all additional information (expressed to be confidential) that ABF may provide in addition to this application.

4 Details of the Participants

- 4.1 The participants are ABF and BP.
- 4.2 The contact details for ABF are as follows:

C/- George Weston Foods Limited
Level 20
821 Pacific Highway
Chatswood
NSW 2067
(PO Box 5579
West Chatswood
NSW 1515)
Australia
Telephone: 0061-2-9414 3830
Facsimile: 0061-2-9415 4178
Attention: Tim Wong, Group General Counsel
E-mail: Tim_Wong@gwf.com.au

4.3 The contact details for BP are as follows:

Burns Philp
Level 2
44 Martin Place
Sydney
NSW 2000
Australia
Telephone: 0061-2-9227 9371
Facsimile: 0061-2-9223 1234
Attention: Helen Golding, Company Secretary and Group Legal Counsel
E-mail: helen.golding@burnsphilp.com

5 **Who is interconnected to or associated with each participant?**

Acquirer

5.1 ABF is (indirectly) a wholly-owned subsidiary of ABF plc.

5.2 GWF is a wholly-owned subsidiary of Allied Foods (NZ) Limited, which in turn is a wholly-owned subsidiary of George Weston Foods Limited of Australia. George Weston Foods Limited, in turn (through interposed companies), is a wholly-owned subsidiary of ABF plc. Further corporate information can be obtained at www.gwf.com.au and www.abfoods.com.

Target

5.3 BP is listed on the Australian stock exchange. A copy of BP's 2003 Annual Report is available at www.burnsphilp.com.

5.4 There are a number of operating subsidiaries in the BP group in New Zealand, in particular those acquired as a result of the takeover of Goodman Fielder in 2003. ABF is unaware of all the relevant subsidiaries of BP or Goodman Fielder. The key subsidiary for the purpose of this application is NZFI.

6 **Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant?**

No participant has a beneficial interest in another participant.

7 **Identify any links, formal or informal, between any participant(s) including interconnected bodies corporate and other persons identified at question 5 and its/their existing competitors in each market.**

There are no common links between the participants or interconnected bodies

corporate in any relevant market other than for the supply of yeast by NZFI to GWF on standard commercial terms; and an equipment loan agreement between NZFI and GWF relating to liquid cream yeast installation equipment.¹ In the United Kingdom, ABF plc and BP are equal participants in a yeast joint venture (Mauri Products Limited) established in April 1980, that appears likely to be collapsed into one entity on completion of the Acquisition. BP and ABF plc are also participants, together with Irish Sugar plc, in an Irish joint venture, Proofex Products Company. There are various supply agreements with these joint ventures, and similarly between ABF plc companies and BP yeast manufacturers worldwide.

8 Do any directors of the “acquirer” also hold directorships in any other companies which are involved in the markets in which the target company/business operates?

There are no common directorships.

9 What are the business activities of each participant?

9.1 ABF plc is an international food, ingredients and retail group based in the United Kingdom with annual sales of £4.9 billion and over 35,000 employees. ABF plc operates businesses in four segments: grocery, primary foods and agriculture, ingredients and retail. The ABF plc Group has sales worldwide and manufacturing operations across Europe, North America, Asia, Australia and New Zealand. Further corporate and operational information is available at www.abfoods.com.

9.2 ABF is (indirectly) a wholly-owned subsidiary of ABF plc. ABF is a holding company for ABF plc’s various UK and overseas subsidiaries.

9.3 GWF is part of the ABF plc group. GWF’s immediate parent (through one interposed company) is George Weston Foods Limited in Australia which largely controls operations in New Zealand as well as, of course, in Australia. In Australia, there are three key business groups:

- Consumer products (Baking – Tip Top bread, Tip Top packaged retail flour and Kitchen Collection packaged retail bread mixes; Meat and Dairy – Don Smallgoods, Melosi, Watsonia and Chapmans)
- Ingredients and industrial products (Weston Milling – flour; Cereform – bakery ingredients; Weston Animal Nutrition – stockfeed; Jasol – cleaning products; New Food Coatings (50:50 joint venture with Newlyweds Foods Inc) – breadings, seasonings and spice mixes for the food industry)
- Research and development support services (Weston Technologies)

¹ The agreement, dated 22 December 1997, provides for the loan of certain liquid cream yeast handling equipment by NZFI to GWF.

9.4 Further corporate and operational information is available at www.gwf.com.au.

GWF in New Zealand

9.5 In New Zealand, GWF operates in two of the key business groups including the manufacture, sale and distribution of:

- Consumer products (baking of bread and bakery-related items – Tip Top, Burgen, Ploughmans, Big Ben Pies and Golden Crumpets)
- Ingredients and industrial products (Weston Milling – flours and bread ingredients; Jasol – cleaning and hygiene products)

Burns, Philp & Company Limited

9.6 BP is incorporated in Australia and is a global yeast, food ingredients and consumer-branded food products manufacturer. It has operations in over 28 countries and employs approximately 14,000 people globally. BP's product range includes bakers yeast, yeast extracts, specialty yeast products such as wine/brewers yeast, bakery ingredients and herbs and spices. Following the acquisition of the Goodman Fielder Group, BP increased its product range to include bread, snack foods, breakfast cereals, edible oils and meal components.

9.7 Further corporate and operational information can be obtained at www.burnsphilp.com and www.goodmanfielder.com.au.

NZFI

9.8 BP, through its wholly-owned subsidiary, NZFI owns the only yeast manufacturing plant in New Zealand. NZFI currently supplies all the fresh yeast requirements of various New Zealand bakeries. It also manufactures specialty dry yeasts (but for non-baking purposes). It has approximately [] of the total New Zealand yeast market.

9.9 Previously –including at the time of *Decision 487* – NZFI manufactured and distributed a range of bakery ingredients such as bread improvers, pastry cook and cake mixes. NZFI has since divested this part of its business to Champion Flour Mills (a division of Goodman Fielder). GWF does not manufacture sauces and dressings so that no issue arises in relation to that market. Accordingly, the only relevant market is yeast (and peripherally bread).

10 **What are the reasons for the proposal and the intentions in respect of the acquired or merged business?**

10.1 Globally, the acquisition is intended to consolidate ABF plc's position as a leading international ingredients company and the global acquisition is consistent with its strategy of investing in areas where the ABF plc group has strength and expertise.

- 10.2 ABF's intention is to operate the global yeast business as a stand-alone division within the ABF plc Group, with NZFI as a business unit reporting directly to ABF. NZFI will not be managed by GWF and GWF will be treated no differently from any other customer. This is the same way ABF plc manages its ownership of the Twinings and Ovaltine businesses in New Zealand with both businesses reporting back to the relevant division within ABF plc, and not via the GWF division.
- 10.3 The global acquisition coincides with BP's need to sell NZFI pursuant to the undertaking given to the Commission in *Decision 487*. Efforts have been made by BP to sell NZFI in a stand-alone transaction. Those efforts have, to date, been unsuccessful.
- 10.4 The agreement with ABF did not arise out of these efforts, but has arisen subsequently. The Acquisition (of NZFI) is simply part of a global acquisition.

The Counterfactual

- 10.5 As noted, BP has not to date been successful in selling the NZFI business. If this Acquisition does not proceed, it can be presumed that ultimately another third party will own NZFI. The identity of that purchaser, however, is uncertain.
- 10.6 Relevant also to the counterfactual is the likelihood that, in the future, NZFI may look to negotiate supply contracts with its significant users. This is especially so in view of the increasing threat of imports from Bakels (which is discussed further below); as well as the need for a new owner to recover its investment, particularly given the known cost of relocating the plant to a new site once the Ponsonby Road lease finally expires in less than two years' time. The terms of the Acquisition do not provide for any supply contract between ABF and Goodman Fielder.
- 10.7 Whether NZFI is owned by ABF or a third party BP will be restrained from re-entering the yeast market (on the usual commercial terms). (In ABF's case the restraint is for [].)

Part II: Identification of Markets Affected

Horizontal Aggregation

- 11 **Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition?**
- 11.1 There are **no** markets in which the proposed Acquisition will result in a horizontal aggregation of business activities. However, for the purposes of questions 12 and following (more particularly question 14), the applicant deals conveniently with the issue of market definition below.

Relevant Markets

- 11.2 The relevant markets are:
- a. the New Zealand market for the manufacture and wholesale supply of bakers yeast;
 - b. the markets for the manufacture and wholesale supply of bread in each of the upper North Island, the lower North Island and the South Island.
- 11.3 These market definitions are consistent with accepted competition principles. Those principles emphasise that a market should be defined in a way that best assists the analysis of the competitive impact of the acquisition. The market must, ultimately, be determined, in the words of the Act, as a matter of fact and commercial common sense (a factor recently emphasised in the High Court's decision in *Brambles*).

The Yeast Market

Product

- 11.4 The applicant says that the appropriate product market definition for the purposes of analysing this Acquisition is the manufacture and wholesale supply of all yeast (fresh and dry). Defined in this way, the market includes:
- liquid cream yeast
 - stabilised cream yeast
 - compressed yeast
 - dry yeast

Geography

- 11.5 The geographic market is national. NZFI supplies yeast nationally to a range of large and small bakeries.

Function

- 11.6 The relevant functional level is the manufacture and wholesale supply of bakers yeast.
- 11.7 The following information is provided to explain and support the above market definitions.

The Yeast Market

What is yeast?

- 11.8 Yeast is a living micro-organism belonging to the fungi family. It is grown through a fermentation process utilising a small quantity of yeast, together with molasses, which is obtained from sugar cane. After its fermentation, yeast goes through a separation process where excess water is removed to produce different forms of yeast. Yeast is used in the production of bread and other yeast-related bakery products; also pizza dough bases, beer and wine and Sanitarium Marmite and Kraft Vegemite spreads.
- 11.9 However, it is only bakers yeast which is relevant for present purposes. Bakers yeast is a non-substitutable ingredient used in the manufacture of bread and associated products (rolls, bagels). Bakers yeast performs three functions. It produces carbon dioxide gas which aerates the bread; it develops the dough through the action of fermentation on the gluten structure; and it provides flavour to the bread.

The different forms of yeast – substitutability

- 11.10 The yeast production process is outlined in diagrammatic form in **Attachment 1**. That process produces fresh and dry yeast as follows:
- a. **Liquid Cream yeast.** This is the raw product from the manufacturing process. Fresh cream yeast is distributed directly by the manufacturing facility (NZFI) by refrigerated tanker trucks in 10,000-litre loads. Customers require an installation system to receive the liquid yeast. These systems are generally supplied by the yeast supplier and comprise storage tanks, refrigerated units, piping and related equipment. Liquid cream yeast has a shelf life of approximately 10 days. Liquid cream yeast is used generally by bakeries requiring over 300 tonnes of yeast per annum. NZFI supplies liquid cream yeast to GWF, Goodman Fielder and Yarrows. Their large, high-volume, automated operations are specially designed to use liquid cream yeast in their production process.
 - b. **Stabilised cream yeast.** Stabilised cream yeast is produced by adding to the liquid cream yeast a stabilising gum. Turning liquid cream yeast into stabilised cream yeast involves only the additional variable cost of adding the stabiliser gum. Stabilised cream yeast is produced only in Australia and New Zealand. Stabilised cream yeast is sold in 1,000-litre vats. Customers require a cool room (in which the stabilised yeast is stored in the vats) and a piping system into the dough manufacturing process. These systems are generally supplied by the yeast supplier. Stabilised cream yeast has a shelf life of approximately 10 days. Stabilised cream yeast is generally used by bakeries requiring 100 to 200 tonnes of yeast per annum in New Zealand. NZFI supplies stabilised cream yeast to GWF, Goodman Fielder and Rivermill. (These are generally medium-sized bakeries.)

- c. **Compressed yeast.** Compressed yeast has the water from the cream yeast removed. This is done by processing cream yeast over a rotary vacuum filter drum where the ‘dewatered’ yeast is moved from the filter drum by a knife blade with the resulting crumbled yeast conveyed to the packaging operation. It is extruded into 1kg blocks, wrapped in wax paper and refrigerated until distribution. These blocks are distributed in 18kg cartons. Customers require a cool room (in which the compressed yeast is stored). Compressed yeast has a shelf life of approximately 24 days. Compressed yeast is generally used by smaller bakeries (although note that even the medium-sized bakeries – eg Quality Bakers (Dunedin) which uses [] tonnes annually – may use compressed yeast). NZFI supplies compressed yeast to Goodman Fielder and independents (including supermarkets, hot bread shops and food ingredients wholesalers), and to GWF and Yarrows (but only in very small amounts).
- d. **Dry Yeast.** Dry yeast involves taking crumbled yeast and feeding it through an extrusion process, from which it is then fed into a two-stage drying process. At the end of that process, instant dry yeast is formed. It is 96% dry matter. It is vacuum packed in 500gm packets; also 10 and 15kg blocks. Dry yeast has a shelf life of two years.

Most of the large yeast manufacturing plants worldwide manufacture yeast. NZFI, however, does not manufacture instant dry yeast. The NZFI manufacturing facility is not able to produce instant dry yeast because of its size, age and lack of equipment. Rather, it manufactures specialty dry yeasts. It processes two types. The first is active dry yeast which is sold to suppliers of yeast and baking products for the consumer market (Surebake and Supabake). The second is inactive yeast which is sold to suppliers of health and other related products (eg Sanitarium for its Marmite product).

Previously, NZFI also imported instant dry yeast (for bakeries) from Australia and Vietnam under the Mauripan brand. This part of its business – the importing as well as the distributing – has since been transferred to Champion Flour Mills (a division of Goodman Fielder).

- 11.11 The applicant says that, consistent with market definition principles, the market includes **all** these forms of yeast. As to fresh yeast, GWF and Goodman Fielder use more stabilised, than liquid cream yeast in their national operations. Yarrows does not purchase stabilised cream yeast, but only because of its preference to use liquid cream yeast, given the size of its operation. All these purchasers use varying amounts of compressed yeast.
- 11.12 Compressed yeast can be used in substitution for cream (and dry) yeast. Previously, the industry used largely compressed yeast. It was only approximately 10 years ago that the larger-volume users switched to liquid cream, rather than compressed yeast. Beyond Australasia, because stabilised yeast is not available, bakeries choose between liquid cream and compressed yeast.

- 11.13 An important feature of compressed yeast is that it can be imported without incurring any additional fixed costs.² No holding station is required and there are no special handling requirements other than putting the compressed yeast into a refrigerated container.
- 11.14 While it is acknowledged that the larger bakeries have a strong preference to use cream yeast because of the size of their operations, this does not mean that, in the event of increased prices or reduced service (particularly quality), they would not switch to compressed yeast which performs the same function as cream yeast. All that would be required is some consequential changes to their operational processes.
- 11.15 More particularly, this would involve customers ceasing to use their cream yeast installation systems (generally supplied by the yeast supplier in any event) and employing additional labour to unpack and add the compressed yeast to the dough mix (probably half a full-time employee). Most bakeries will already have a cool room. But if not, a cool room could be installed for as little as \$50,000. However, as a matter of commercial practicality, they would more likely import (liquid) cream yeast which they can readily do (see further below).
- 11.16 The relevant point is that each of these three forms of fresh yeast serve the same function (and indeed each is supplied on the basis of a compressed yeast equivalent price) and are comparably priced.
- 11.17 The applicant notes that the Commission excluded dry yeast from the relevant product market in *Decision 201A* (1987). However, since then, many smaller bakeries (including in-house supermarket bakeries and franchise groups) use dry yeast in the manufacture of their bread.
- 11.18 Dry yeast is imported into New Zealand from the Netherlands, France, Vietnam, China and Australia. Annexed as **Attachment 2** is a table of dry yeast imports into New Zealand sourced from Statistics New Zealand for the 12-month period ending May 2004. This table shows that imports of dry yeast remain relatively stable. DSM Bakery Ingredients, which is a global dry yeast supplier, remains a significant importer of dry yeast (under the Fermipan brand).
- 11.19 A particularly good example of the substitutability of dry and fresh yeast was Woolworths' in-store bakery's business decision in 1999 to switch from dry yeast (imported by NZFI) to compressed yeast. Conversely, in 2000, Progressive Enterprises' in-store bakery switched from NZFI compressed yeast to dry yeast. In 2003, NZFI reduced the price of compressed yeast to the (merged) Progressive Woolworths chain by [] to entice Progressive across from dry yeast (supplied by DSM) to compressed yeast and to incentivise Woolworths to remain with compressed yeast. Therefore, there can be no doubt as to the close substitutability between compressed and dry yeast.

² For example, Burns Philp exports compressed yeast from Vietnam to Thailand. It takes approximately five days to ship the compressed yeast from the factory to the market. Therefore, it would be more than feasible for compressed yeast to be transported from Australia to NZ. Compressed yeast could be imported using a refrigerated container load once a week.

- 11.20 Accordingly, the applicant says that it is appropriate to include fresh and dry yeast in the same market. Clearly, there are preferences for one or the other and the large three industrial bakers do prefer to use liquid cream yeast since it is better able to be handled in high-volume automated processes allowing for the direct feeding of the yeast into bakery mixes. However, as already emphasised, all forms of yeast (including dry yeast) have the same function and pricing is very comparable (see para 11.28 and following below).
- 11.21 Of relevance, the ACCC in its analysis of the BP – Goodman Fielder merger considered that the appropriate market definition was a national market for the manufacture and distribution of fresh (all forms) and dry bakers yeast (see ACCC Decision Note, Feb 2003 (**Attachment 3**)).
- 11.22 However, even if it were appropriate to exclude dry yeast from the relevant market, there can be no doubt that the ability of (at least some) users to switch to dry yeast (particularly as a substitute for compressed yeast) in response to the imposition of a *ssnip* is a competitive constraint (whether dry yeast is included within the product market or not).

Features of the bakers yeast market in New Zealand

- 11.23 The total New Zealand yeast market is approximately \$11 million in revenue annually. Total consumption is approximately 6,000 tonnes (compressed yeast equivalent)³. By comparison with other yeast manufacturing plants, NZFI's operation is very small. NZFI is the only local producer of fresh yeast. Overall, NZFI manufactures and supplies approximately [] of bakers yeast consumed in New Zealand.
- 11.24 The remaining yeast consumption is mainly imported instant dry yeast, principally from DSM; also, however, from Bakels - Lesaffre Yeast Pty Limited in Australia, owned 60% by Saf and 40% by Australian Bakels Pty Limited (**Bakels**). Australian Bakels Pty Limited has a large bakery ingredients operation based in Penrose, Auckland (with an approximate 50% share of the bakery ingredients market) and distributes Bakels dry yeast under the Bake Safe brand.
- 11.25 Yeast comprises a very small amount of the price of bread – as little as [] depending on the price of the bread (\$1.00 to \$1.80).

Customers

- 11.26 Profiles of NZFI's key customers are provided below.

³ As noted in Appendix 1, liquid and stabilised cream yeast are supplied, in terms of volume and price, on a compressed yeast equivalent basis.

a. **Goodman Fielder NZ (Quality Bakers)**

Goodman Fielder NZ's bakery division is the largest loaf bread producer in New Zealand. Goodman Fielder NZ markets its bread under brand names such as Quality Bakers, Vogels and Freyas.

b. **George Weston Foods**

GWF produces bread in New Zealand under brand names such as Tip Top, Burgen and Ploughmans.

c. **Yarrows**

Yarrows is a family-owned baking business that has been based in Manaia, Taranaki for over 80 years. In addition to its branded bread lines in New Zealand, Yarrows is a major producer and exporter of frozen dough and makes the dough for Subway sandwich stores in New Zealand, Australia, Singapore, Japan and Taiwan. Yarrows has a bakery in Perth (using fresh cream yeast). It also has a sales facility with freezer capacity in Brisbane.

d. **Rivermill**

Rivermill is an independent, privately-owned bread and ingredients manufacturer based in Huntly. Rivermill sells its bread products primarily through smaller retailers throughout the North Island.

e. **Coupland**

Coupland is a South Island bakery. Coupland sells its bread products primarily through its own, and other smaller retailers in the Canterbury region.

f. **In-house supermarket bakeries**

Both the Progressive and Foodstuffs chains have in-house bakeries in their major supermarkets. Their in-house bakeries bake a full range of breads (and associated products like rolls and bagels) which compete with the packaged breads. (The supermarkets are both producers and retailers – vertical integration backwards.) Progressive is a significant user of yeast from NZFI. Foodstuffs purchases only a small amount of yeast from NZFI since it purchases its dough ready-made from Yarrows.

g. **Other bread shops**

A range of hot bread shops –including franchise operations like Bakers Delight (37 stores) and Brumby's (19 stores) – operates throughout the country (some of whom purchase their yeast supplies from NZFI).

- 11.27 Annexed as **Attachment 4** is a table providing the total market shares of yeast by end users. Notably, the table demonstrates how reliant NZFI – if this Acquisition proceeds – will be on purchases from Goodman Fielder, Yarrows and the independents given that GWF’s own yeast usage is comparatively small, ie [] ([] if focusing only on cream yeast).

Pricing

Fresh Yeast

- 11.28 NZFI prices all three forms of its fresh yeast on a national basis. (This is a preference of its key customers which, despite the different locations of their bakeries, prefer uniform pricing.) The manufacture of yeast involves high fixed costs and accordingly throughput is critical to NZFI’s profitability.
- 11.29 That being the case, NZFI uses, as one of the key determinants of its prices, the estimate of the price that Bakels could sell at in New Zealand (with fresh yeast shipped from Australia). For a more detailed explanation of NZFI’s pricing behaviour (now and post – Acquisition), see the accompanying report by Charles River Associates (“**CRA**”).
- 11.30 NZFI has not, except for a small price increase to Goodman Fielder and GWF during 2003 to recover additional utility costs, increased its yeast prices for more than six years.

Dry Yeast

- 11.31 Because dry yeast is more concentrated than fresh yeast, it provides approximately three times the leavening for bread and bakery products as the same weight of fresh yeast. As a result, dry yeast prices per unit of weight are approximately three times those of fresh yeast. But when this difference is taken into account, fresh and dry yeast prices are comparable.
- 11.32 Current yeast prices for each of the different forms of yeast are set out in **Attachment 5**.

Summary

- 11.33 In summary, the applicant says that the appropriate market definition is the national market for the supply of yeast (fresh and dry). As a matter of fact and commercial common sense, all forms of yeast are substitutable. Whether a particular bakery chooses to use one form of yeast only, or a combination of different forms of yeast, will depend on the size of its operation and preference. The degrees of substitution (on both the demand and supply side) between the different forms is set out in diagrammatic form in Figure 1, p2 of the CRA report.

11.34 However, while it is the applicant's view that the product market includes all types of yeast (consistent with the ACCC's view), market definition is not in fact critical in this case since the only competition issue arising is one of vertical, rather than horizontal aggregation.

The Bread Market(s)

11.35 The applicant considers that any issues in relation to vertical integration downstream – in the markets for the manufacture and supply of bread – are peripheral only. Therefore, only brief mention is required as to the relevant bread markets, ie the manufacture and wholesale supply of bread in the upper North Island, lower North Island and South Island markets.⁴ This is also especially when market definition is not, in any event, critical to any issues arising downstream.

11.36 Previously the Commission in *Decision 289* defined the relevant product markets as packaged bread. However, developments since then show that packaged and non-packaged bread (particularly with the proliferation of in-house supermarket bakeries and franchise bread bakers) compete head on. (However, even if the product market is packaged bread only, this makes no difference to the competition analysis in this case.)

11.37 It may also be arguable whether geographically the relevant markets remain upper North Island, lower North Island and South Island. However, any issue as to the appropriate geographical dimension(s) makes no difference to this application. Therefore, GWF is content, for the purposes of this application, to rely on the Commission's geographical market definitions in *Decision 289*.

11.38 As to function, the Commission appeared to define a wholesale market in *Decision 289* but recognised that there was increasing vertical integration. This vertical integration has become even more a feature of the market(s) and so has increased the competitive pressure on the plant bakers and led to a blurring of the functional levels.

11.39 The wholesale markets are very competitive. The larger industrial bakeries, Goodman Fielder, GWF, Yarrows (Lower North Island) and Rivermill (upper North Island) face strong competition and increasing consumer preference for specialty breads. There has been a proliferation of specialty hot bread shops and in-house bakeries in supermarkets with the result that the wholesale/retail functions have become blurred and the plant bakeries are competing directly with the vertically integrated bakery retailers. Supermarkets in particular are now a major driver of price competition in bread sales providing a countervailing force to bread manufacturers.

11.40 Annexed as **Attachment 6** is the applicant's best estimate of national market shares for the production and wholesale supply of bread.

⁴ These are the geographic markets as the Commission defined them in *Decision 289* (Goodman Fielder/Defiance Mills Limited)

12 **Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).**

12.1 Yeast is essentially a standardised product, albeit that it comes in different forms. Buyers make their purchases largely on the basis of price and form although quality and security of supply are also key drivers.

12.2 Breads are differentiated in terms of ingredients and type (brown, white, energy, grain); their packaging (packaged, non-packaged etc); and branding. All the different types of breads, however, remain close substitutes.

13 **Differentiated product markets**

See question 12 above

Vertical Integration

14 **Will the proposal result in vertical integration between firms involved at different functional levels?**

14.1 The Acquisition raises solely a potential vertical integration issue in respect of ABF ownership of NZFI's yeast business. Vertical integration, of course, is not of itself a barrier to competition. Vertical integration will be an issue only where it results, or is likely to result, in substantial market power being strengthened or leveraged into another market: Commission Guidelines, para 10.1.

14.2 As the Commission notes, some of the competition concerns that may be raised by vertical integration include:

- Increased entry barriers;
- Access concerns;
- Foreclosure of entry into one or other of the vertical levels affected;
- Facilitation of co-ordination effects.

14.3 In *Decision 487*, the Commission identified two possible competition concerns arising from a vertically integrated BP-owned NZFI, ie:

- Entry barriers would be increased upstream (yeast), because importing would be made more difficult; and/or

- A possible leveraging of market power in the upstream market through raising rival costs, disrupting supply or co-ordinated effects in the downstream market (bread).

14.4 The applicant says that even if these concerns were valid in the BP – Goodman Fielder case (although it is arguable they were not), they do **not** apply here for the reasons set out below. Vertical integration will not result in either a strengthening of any market power in the yeast market, or its being leveraged into the bread markets.

Entry barriers are not increased – importing is not made more difficult in relation to yeast.

14.5 Vertical integration will **not** result in increased entry barriers (by importing being made more difficult). NZFI will remain constrained by the very real threat of imports and that threat will constrain it from attempting to raise prices or reduce service. Vertical integration will not change that.

14.6 Although the Commission discounted the threat of imports from Bakels in the BP – Goodman Fielder decision, there are some significant differences between a Goodman Fielder, and ABF, owned NZFI. Those differences are set out below:

Level of Vertical Integration is Less

14.7 GWF has only a [] share of the yeast market. Accordingly, the level of vertical integration arising from this Acquisition is significantly less than the vertical integration which was involved in the BP – Goodman Fielder case, i.e. [], cf [] (or [] cf [] in relation to cream yeast only).

14.8 Although vertical integration may result in different incentives for an ABF-owned NZFI (although it should be emphasised that ABF will operate NZFI as a stand-alone business from GWF), the important point is that its ability to raise prices will remain unchanged. If anything, vertical integration will heighten the prospects of imports and therefore put greater pressure on NZFI's pricing (see further below).

Bakels will not be weakened

14.9 Bakels will **not** be weakened as a result of the vertical integration arising from this Acquisition. Subsequent events have shown that the Commission's predicted scenario in *Decision 487* (even if valid at the time) – ie that Bakels would lose market share – has not happened. Following the Acquisition, Goodman Fielder did not, as the Commission assumed, switch all its supply in Australia to a vertically integrated BP (Aust). Goodman Fielder since then, and still now, purchases the majority of its Australian yeast requirements from Bakels.

14.10 More importantly, since then GWF (Aust) has switched all its supply (except for Queensland) from BP (Aust) to Bakels showing clearly the competitive tension

between the two Australian suppliers. The effect of these changes is that Bakels now has approximately [] of the Australian (fresh) yeast supply (cf previously, at the time of the BP – Goodman Fielder acquisition, a [] share). Annexed as **Attachment 7** is information relating to current yeast supply and market shares in Australia.

14.11 GWF (Aust) is contractually committed to purchase [] its yeast requirements from Bakels []

[] Therefore, Bakels will not lose any business in Australia as a result of this Acquisition. Accordingly, the Commission need not be concerned (as it was previously) that Bakels may be weakened as a result of this Acquisition and so making it less competitive as an exporter.

14.12 But even if the Acquisition meant that Bakels did lose some of GWF (Aust's) business (although as emphasised this will not, in fact, be the position), it would more than likely be offset by Bakels obtaining more of Goodman Fielder (Aust's) business. Goodman Fielder (Aust's) business is up for tender in []

14.13 There are capacity issues which also mean that BP (Aust) could not supply both Goodman Fielder and GWF's total requirements in any event. The Commission is referred to **Attachment 7** which shows that with a capacity of [] tonnes (cf Bakels 28,000 tonnes) BP is not in a position to supply both companies' total requirements as well as the requirements of other yeast users.

14.14 Moreover, commercial reality and common sense suggest that if Bakels did lose business in Australia as a result of this Acquisition, then this is only likely to incentivise Bakels to find other markets as long as it covers its incremental costs and contributes to its existing sunk costs (see section 4.3 of the CRA report).

14.15 Bakels presently has excess capacity and the ability to supply New Zealand customers from low marginal cost. ABF estimates that the additional investment which Bakels would need to make to establish a liquid yeast cream station in New Zealand is approximately [] (with additional operating costs): see **Attachment 8**. The additional liquid cream yeast equipment which would need to be installed on bakers' premises is estimated to be in the range of []⁵. There would be no investment costs for Bakels to import compressed yeast.

⁵ **Attachment 8** explains that the usual practice is to transfer the existing liquid cream system equipment to the new supplier at net written down book value. Net book value of Yarrows' equipment is []; GWF's [] and Goodman Fielder's []. But note that, because Goodman Fielder owns its own liquid cream equipment, this additional investment would not be required if Bakels were to supply Goodman Fielder's yeast requirements.

Imports – Recent Events

- 14.16 It is now apparent, contrary to what the Commission may have been told in the BP – Goodman Fielder case, that potential imports from Bakels into New Zealand are a very real prospect and vertical integration will not change that.
- 14.17 The Commission is referred to **Attachment 8** which sets out the information (including recent developments) on which the applicant relies to demonstrate the significant, and very real prospect of imports by Bakels into New Zealand in the future.⁶
- 14.18 In particular, the applicant refers to Section 3 of **Attachment 8** which provides the Commission with information [

.]

14.19 [

.]

14.20 [

.]

14.21 [

.]

14.22 The applicant's view that Bakels will not be weakened as a result of the vertical integration arising from this Acquisition is developed further in the CRA report. CRA confirms that, from an economic viewpoint, the very real prospect of imports will continue to be a constraining factor on NZFI's pricing and quality of product. Vertical integration (to the level of []) will not change that.

NZFI Reliance on Yeast Products

14.23 NZFI will clearly be reliant upon ongoing purchases by Goodman Fielder and Yarrows to utilise capacity and maintain efficiencies given that GWF's total share of the yeast market is [] only. Financially, it will need the throughput to maintain profitability so that it would be counter intuitive for it to raise prices and risk the possibility of Yarrows and/or Goodman Fielder switching supply to Bakels.

⁶ []

14.24 Moreover, Goodman Fielder will have the ability to exercise its countervailing power arising from its trans-Tasman position, given the importance to BP (Aust) of Goodman Fielder's yeast purchasing business. [

.]

14.25 To that extent, nothing will change as a result of vertical integration. NZFI is currently supplying Goodman Fielder, George Weston and Yarrows. It can be expected, especially with the increasing threat of imports from Bakels, that NZFI will fight hard to continue to supply these customers post-Acquisition.

14.26 The applicant is aware that NZFI provided the Commission with considerable financial information in the course of the BP – Goodman Fielder proposed acquisition as to the consequences for NZFI if it lost one of its major customers, such as (then) GWF. The applicant refers to and relies on that information (as well as the updated information provided to CRA for the purposes of its report: see Table 3, p 7). Put simply, an ABF-owned NZFI cannot put at risk its business investment, so that it must always price to ensure retention of these customers. It will not have the ability to raise prices or reduce services.

Dry Yeast

14.27 Other users of fresh yeast – especially the smaller bakeries using compressed and stabilised yeast – have the ability to switch to dry yeast. This will remain a competitive constraint on NZFI. Vertical integration will not change that.

Summary

14.28 The applicant says that for all the reasons above, and supported by the CRA report, the level of vertical integration in this case will not result in the strengthening, nor exercise, of any market power in the yeast market.

Downstream Market: (Bread) Leveraging and Co-ordination Effects

Bread – Raising Rivals' Costs

14.29 In *Decision 487* the Commission suggested that vertical integration, in the case of a BP-owned NZFI, might result in NZFI supplying liquid cream yeast on terms that were relatively disadvantageous to competitors or at a degraded quality.

14.30 The applicant says – and refers to the CRA report in support – that any such concerns are groundless. As CRA explains, such a strategy would be dependent on NZFI's ability to raise its yeast prices to other bread manufacturers; also GWF's ability to raise its bread prices in the downstream market. Neither of those requirements could be met in this case.

- 14.31 In any event, it would not be profit-maximising behaviour for ABF (through NZFI) selectively to increase the price of fresh yeast to users given the limited cost that yeast comprises in a loaf of bread against the economic detriment of the risk of loss of volume sales. This is especially so when the yeast price is such a small component of the bread price.
- 14.32 Furthermore, in practical terms, NZFI could not provide degraded yeast to some of its customers. All customers have certain product specifications which NZFI must meet. Since bakeries make bread 363 days a year, a bakery would know very quickly if its yeast was not meeting required performance specifications and would react accordingly. NZFI could expect to face claims of breach of contract. Also, because yeast production is a batch process, it would be practically very difficult to take out yeast from that batch, deliberately ‘degrade’ it, and then supply to the targeted customer(s).

Co-ordination Effects

- 14.33 Vertical integration would **not** result in co-ordination effects in the downstream market for the manufacture and supply of bread because:
- (a) the bread manufacturing and supply market(s) is competitive and not conducive to collusion; and
 - (b) ownership by ABF of NZFI will not change that so there is no causal link.
- 14.34 The following table applies the factors considered by the Commission to be relevant (whether by horizontal or vertical integration) to an assessment of whether or not an acquisition could substantially lessen competition by the facilitation of the exercise of co-ordinated market power.

Table 1: Co-ordination Effects

Factors Conducive to Collusion	Presence of Factors in the Market
High seller concentration	No: While there are four main players – GWF, Goodman Fielder, Yarrows and Rivermill – many other producers and suppliers of bread exist in the market(s).
Undifferentiated product	No: Breads are differentiated.
Static Technology	No: The industry is subject to technological change, although incremental, in relation to recipes and types of bread resulting in a dynamic market(s) and business models. Technology is less dynamic in relation to the basic infrastructure (ovens and related equipment).
New entry slow	No: New entry – particularly by in-house supermarkets and smaller bakeries – is fast. Entry is only slow in relation to major bread manufacturing.
Lack of fringe competitors	No: There are many independent bakeries, including supermarket in-house bakeries and hot bread shops.
Acquisition of a maverick business	No: NZFI is the sole – and stable – supplier of fresh yeast in New Zealand.
Price inelastic market demand	Yes: Bread is a staple item of people’s diets. But, the residual demand curves facing each player are likely to be elastic because of competition and the dynamic nature of the industry.
History of anti-competitive behaviour	No: (Apart from localised instances of price fixing (1996) and resale price maintenance (1990), neither of which involved GWF).
Presence of industry association	Yes: New Zealand Association of Bakers and New Zealand Bakery Society.
Buyers will not constrain	No: Buyers include the supermarkets which have considerable countervailing power which would undermine any co-ordinated effects.

14.35 Application of the Commission's own checklist factors shows that the market is far from conducive to collusion and the Acquisition will not change that in any way. Indeed, vertical integration is in fact likely to make the market less susceptible to collusion. The Commission recognises in its Guidelines that the effect of vertical integration is usually to make collusion more difficult (see also the CRA report on this issue).

14.36 Finally, an important difference also between this case and a BP-owned NZFI, is that, as with yeast, the level of vertical integration into the bread market(s) is substantially less: cf [] with [].

15 **Acquisition of assets of a business or shares involving either participant in the last three years (whether or not notified to the Commission)**

15.1 To the best of ABF's knowledge, there has been only one proposed acquisition involving a participant in the relevant markets and notified to the Commission in the last three years. BP sought to acquire up to 100% of the ordinary issued share capital of Goodman Fielder.

15.2 The Commission cleared the acquisition on 21 February 2003 (*Decision 487*) subject to the divestment of BP's yeast business – NZFI. The cleared acquisition did take place.

Since Parts III and IV relate primarily to horizontal aggregation issues (of which there are none), the applicant does not address the remaining parts of the Commission's standard form. Relevant information relating to competitive constraints, potential entry and co-ordinated market power issues have already been dealt with in question 14 insofar as they are relevant to the single issue arising in this case (ie vertical integration).

THIS NOTICE is given by Tim Wong on behalf of ABF Overseas Limited (“the Applicant”). I am the Group General Counsel of George Weston Foods Limited, and am authorised to make this application on behalf of the Applicant in respect of the notice seeking clearance dated 30 July 2004 (“Application”).

I hereby confirm that:

- all information specified by the Commission has been supplied;
- all information known to the Applicant which is relevant to the consideration and determination of the Application has been supplied; and
- all information supplied is correct as at the date of the Application.

I undertake to advise the Commission immediately of any material change in circumstances relating to the Application.

Dated this 30th day of July 2004

Authorised Signatory