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COMMERCE COMMISSION

Decision No. 590

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

TOLL OWENS LIMITED

and

JOHN RAY LIMITED

The Commission:	Paula Rebstock Donal Curtin Denese Bates QC
Summary of Application:	The application of Toll Owens Limited to acquire the log marshalling assets of John Ray Limited.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	**11 October 2006**

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 6 September 2006. The notice sought clearance for the acquisition by Toll Owens Limited (Toll Owens or the Applicant) of the log marshalling assets of John Ray Limited (John Ray).

2. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:

   ▪ the provision of log marshalling services at Centreport;

   ▪ the provision of log stevedoring services at Centreport;

   ▪ the provision of log marshalling services at Port Taranaki; and

   ▪ the provision of log stevedoring services at Port Taranaki.

3. In the relevant factual scenario, at Centreport and Port Taranaki, Toll Owens would acquire the log marshalling assets of John Ray, and accordingly would be the sole provider of log marshalling services at these ports.

4. The Commission considers that the most likely counterfactual scenario would be John Ray continuing to be the sole provider of log marshalling services at Centreport and Port Taranaki.

5. As the markets for log marshalling are defined as port specific, the proposed acquisition would not result in any horizontal aggregation – rather there would be a bare transfer of an existing market position from John Ray in the counterfactual to Toll Owens in the factual.

6. In Decision 533 the Commission considered John Ray as a likely entrant in the provision of log marshalling services at the Port of Tauranga. The Commission has re-assessed whether this is still the case, and whether the acquisition removes a potential entrant into other log marshalling markets. The Commission has concluded that John Ray is not considered to be a likely competitor in other ports as [ ] industry participants did not consider John Ray to be a likely entrant. The Commission accordingly considers that this proposed acquisition would not result in the loss of a potential entrant.

7. The Commission assessed whether there would be a substantial change in the competitive constraint imposed by likely entry into log marshalling. The Commission considers that there is no significant difference between the factual and the counterfactual, as the requirements for entry would not change and Toll Owens would not gain any strategic advantage in the factual.

8. In the factual scenario, the proposed acquisition would result in vertical integration in both Centreport and Port Taranaki due to Toll Owens' existing stevedoring operations at both ports. In the factual scenario at Port Taranaki, Toll Owens would be the sole provider of log stevedoring and log marshalling services; whilst at Centreport, Toll Owens would have a [ ] market share of the log stevedoring services and would be the sole log marshaller.

9. The Commission notes that the vertical integration does not amount to classic vertical integration in the normal sense, as there is no upstream firm that provides an essential intermediary input to a downstream affiliate as both log marshallers and log stevedores contract directly with the exporter. This means a number of the concerns that could arise when vertical integration occurs do not arise with this particular acquisition.

10. The Commission has assessed the impact of vertical integration and considers that compared to the counterfactual, the vertical integration resulting from the proposed acquisition would be unlikely to give rise to a substantial lessening of competition because:

    - there would not be increased entry barriers in the factual scenario, given exporters' strong preference and ability to request an unbundled service for log marshalling and log stevedoring. Therefore, it would not be necessary to enter both log marshalling and log stevedoring markets simultaneously;
    - exporters have a strong preference for an unbundled service, and log exporters have considerable countervailing power;
    - vertical integration is unlikely to facilitate collusion because ISO and QM, which both compete vigorously with Toll Owens in log stevedoring and log marshalling respectively, would remain un-integrated in the factual;
    - there is no ability for either log marshaller or log stevedore to foreclose entry into either market as log exporters and log stevedores each contract directly with the exporter, and as such, it is the relationship with the exporter which is essential for entry; and
    - there would not be concerns regarding restricted access to an essential facility or intermediary input, as the only area where this could potentially arise is in the flow of information between log marshallers and log stevedores relating to the description of the log cargo. Industry participants were unaware of any past instance of such behaviour.

11. The Commission also assessed the countervailing power of log exporters regarding their ability to sponsor new entry into the log marshalling market. The Commission recognises that there are obstacles in sponsoring a new entrant, such as:

    - the new entrant would need sufficient volumes to justify entry;
    - the new entrant would need access to ports; and
    - a new entrant would need to overcome logistical difficulties such as securing contracts with a number of different exporters at a port.

12. However, a number of significant industry participants expressed the view that sponsored entry is likely and the Commission considers that these barriers would be likely to be overcome. Accordingly, the Commission concludes that the threat of sponsored entry would be likely to offer constraint on the log marshalling operations of Toll Owens at Centreport and Port Taranaki in the factual scenario.

13. The Commission is therefore satisfied that the proposed acquisition would not have, nor be likely to have, the effect of substantially lessening competition in any market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered by the Commerce Commission (Commission) on 6 September 2006. The notice sought clearance for the acquisition by Toll Owens Limited (Toll Owens), or the Applicant, of the log marshalling assets of John Ray Limited (John Ray).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 27 October 2006.
3. The Applicant sought confidentiality for specific aspects of the Application. The Applicant advised that some of the information was commercially sensitive and its release would prejudice the Applicant and/or John Ray, as per s 9(2)(b)(ii) of the Official Information Act 1982.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1]

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal will not have, or would not be likely to have, the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition, then it is required to grant clearance to the application. Conversely, if the Commission is not satisfied, it must decline. The standard proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

> We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provided a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.[3]

7. In determining whether there is a change along the spectrum which is significant, the Commission must identify a real lessening of competition that is not minimal.[4]

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines, January 2004.*
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] *Air New Zealand & Qantas Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.
[4] Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and the creation, enhancement or facilitation of the exercise of market power, may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.

9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to access whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

    - with the acquisition in question (the factual); and
    - in the absence of, or without, the acquisition (the counterfactual).

11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:

    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or supplies.

THE PARTIES

Toll Owens Limited

12. Toll Owens is a joint venture company owned 50% by Port of Tauranga Limited (POT) and 50% by Toll Limited. Toll Owens has a presence at all New Zealand ports. Its activities include:

    - marshalling;
    - stevedoring;

- warehousing;
- ships agency;
- transport; and
- cruise line services.

13. POT owns and operates the wharf infrastructure and marine services at Tauranga. It also has a rail link to Metroport in South Auckland, and a 50% interest in Northport Limited, which provides port services in Northland, and a 33% interest in Northport Services Limited, which supplies various on-wharf services, including marshalling at Northport.

14. Toll Limited's other operations are carried out by its subsidiaries:

    - Toll Networks (NZ) Limited carries out courier services (Toll Priority) and international freight forwarding services (Toll International); and
    - Toll Logistics (NZ) Limited is a contract logistics business running primarily warehousing and distribution operations out of Christchurch.

John Ray Limited

15. John Ray is a privately-owned company. Its business activities are:

    - log harvesting;
    - log marshalling services;
    - coal marshalling; and
    - earth excavation.

16. John Ray operates at two ports: Centreport, in Wellington; and Port Taranaki, in New Plymouth. John Ray also owns a part share in the Waitane Sawmill.

OTHER PARTIES

Carter Holt Harvey Limited (CHH)

17. Rank Group Investments Limited purchased CHH in March 2006. CHH is a wood fibre products company and carries on business activities in forests, wood products, pulp and paper, packaging and building supplies. CHH is one of the largest forest product companies in the Southern Hemisphere.

18. CHH is currently selling its forestry estates located in Northland, Auckland, the Central North Island plateau (CNI) and Nelson. CHH is retaining approximately [ ] hectares of forests, which it will be converting into dairy farm land.

Centreport Wellington Limited (Centreport)

19. Centreport owns and operates the wharf infrastructure and marine services at Wellington. Centreport is owned solely by the Greater Wellington Regional Council, and its objective is to ensure commercial success at the port. Currently approximately [ ] cubic metres of log cargo passes through Centreport each year.

Forest Owner Marketing Services Limited (FOMS)

20. FOMS is a privately-owned company, its primary shareholder being Tokomaru East Forestry Co. Limited. It harvests and markets radiata pine for private forest owners in the lower North Island. FOMS supplies the majority of logs that are exported out of Port Taranaki.

Hancock Natural Resource Group (Hancock)

21. Hancock develops, manages and markets international timberland portfolios on behalf of investment groups. In New Zealand, Hancock manages the production of pruned saw logs, unpruned saw logs and pulp logs, mostly in the CNI.

International Stevedoring Operations Limited (ISO)

22. ISO operates at the following ports: Marsden Point, Auckland, Tauranga, Gisborne, Napier, Centreport, Nelson, Picton, Timaru and Bluff. It is involved in log stevedoring, general cargo marshalling and stevedoring. ISO carries out approximately [ ].

Kaingaroa Timberlands (Kaingaroa)

23. Kaingaroa is wholly-owned by the non-profit Harvard Management Company, part of the endowment fund of Harvard University. Kaingaroa is the owner of crown forest licenses in the CNI.

24. Kaingaroa contracts with Timberlands Limited (Timberlands), an employee-owned private company, to manage its New Zealand operations.

Pacific Forest Products Limited (PFP)

25. PFP is an employee-owned private company, with three shareholders. It trades logs and lumber, and provides marketing services for log exporters. PFP exports approximately [ ] tonnes of logs per annum. It operates at: Marsden Point, Tauranga, Gisborne and Napier, as well as periodically from other ports.

Pedersen Group of Companies (Pedersen)

26. Pedersen comprises three privately-owned and operated companies: Pedersen Holdings Limited, Pedersen Industries Limited and Lakesawn Lumber Limited. Pedersen operates a sawmill, processes timber and also exports forestry products.

Pentarch Forest Products Limited (Pentarch)

27. Pentarch is a subsidiary of Pentarch Forest Products Pty Limited, an exporter of plantation grown radiata pine from Australia and New Zealand. Pentarch manages log harvesting and markets logs both domestically and internationally.

Port Taranaki Limited (Port Taranaki)

28. Port Taranaki is wholly-owned by the Taranaki Regional Council. Port Taranaki owns and operates the wharf infrastructure and marine services at New Plymouth. Currently approximately [ ] cubic metres of logs passes through Port Taranaki each year.

Quality Marshalling Limited (QM)

29. QM is a division of the Lambert Group and provides log marshalling services at the Port of Tauranga. It commenced operations in 1991, after CHH approached the Lambert Group with a view to obtaining log marshalling services at the Port of Tauranga.

30. QM also marshals and stevedores woodchips in Napier.

Rayonier New Zealand Limited (Rayonier)

31. Rayonier is a subsidiary of Rayonier Incorporated, a US company. Rayonier:

- manages and runs Matariki Forests Limited, which is 40% owned by Rayonier Incorporated, 40% by AMP Limited and 20% by Deutsche Bank AG; and
- manages forestry contracts for other forestry companies and log traders.

Rotorua Forest Haulage Limited (Rotorua Forest Haulage)

32. Rotorua Forest Haulage is a privately-owned log trucking firm. It operates in most of the CNI and undertakes trucking and haulage. It owns and operates approximately 130 logging trucks and 65 loaders. It provides services valued at about [ ].

Southern Cross Stevedores Limited (Southern Cross)

33. Southern Cross operates at every port in New Zealand through different subsidiaries. It is involved in general cargo stevedoring, log stevedoring and general cargo marshalling. Southern Cross also cross-hires labour to other marshalling and stevedoring companies.

Tasman Bay Stevedoring Company Limited (Tasman Bay)

34. Tasman Bay is a trading division of Port Nelson Limited. Tasman Bay carries out general marshalling and stevedoring, as well as log stevedoring. Tasman Bay operates in Nelson, Picton and Timaru. Tasman Bay employs [ ] and its annual turnover is approximately [ ].

TPT Forests Limited (TPT)

35. TPT is a privately-owned forest products sales and marketing company. It exports logs from: Tauranga, Napier, Gisborne, Taranaki, Centreport, Timaru and Lyttelton. TPT exports approximately [ ] tonnes of logs per annum.

INDUSTRY BACKGROUND

36. The Application involves the provision of log marshalling services at Port Taranaki and Centreport. Log marshalling is a step in the process of log exporting, as set out below.

The structure of log exporting

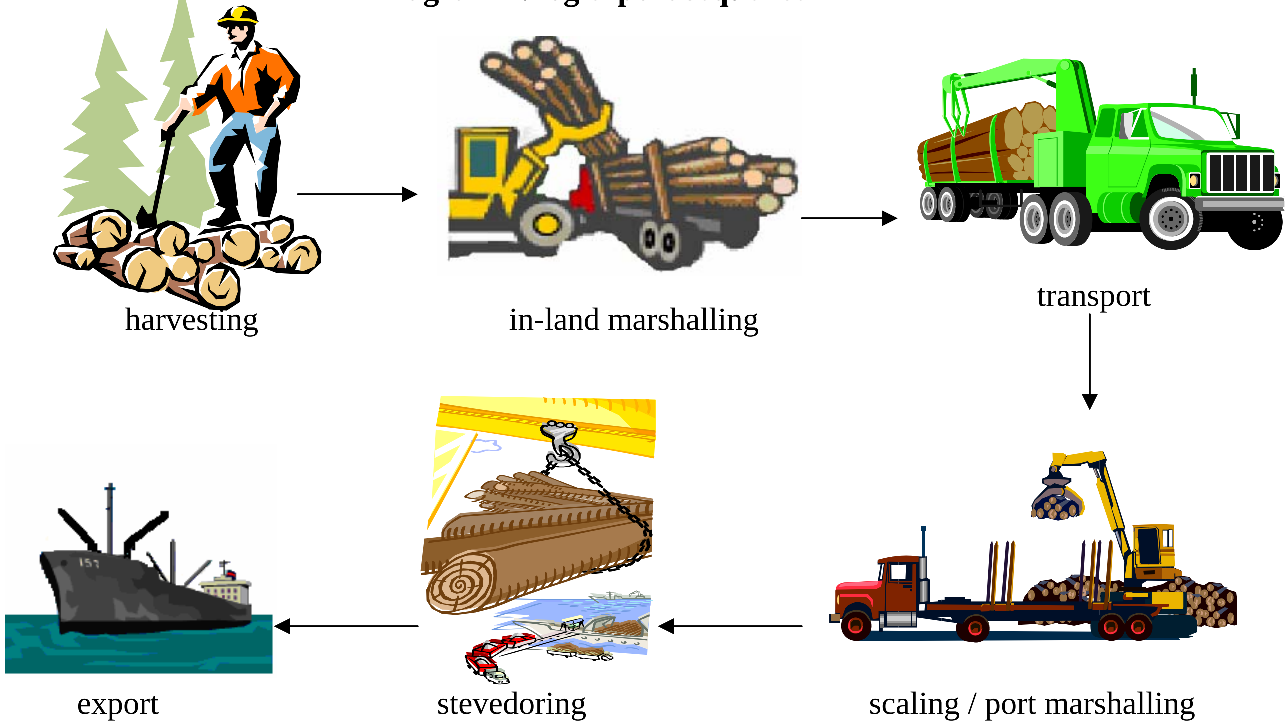
37. In 2006, 5.2 million tonnes of logs were exported from New Zealand, valued at $476.5 million. This has dropped considerably from 2002 when 7.9 million tonnes, valued at $775 million, were exported. [5]

38. The process of bringing a log to export involves the following functional stages:

- harvesting;
- in-land marshalling;
- transport (either rail or truck);[6]
- port marshalling;
- stevedoring; and
- export.

39. Together, these stages (illustrated by Diagram 1) comprise the log supply chain. Ownership of the logs either remains with the forest owner, which exports in its own right; or passes to a marketing company that exports the logs. Both these types of exporters contract with the marshallers and stevedores to provide services.

Diagram 1: log export sequence[7]



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[5] Source: Forestry Statistics Section, Policy Innovation and Research Group, Ministry of Agriculture and Forestry estimates available on www.maf.govt.nz .

[6] At the ports relevant to this decision, there is no rail transportation for logs.

[7] All logs exported through Port Taranaki or Centreport are transported to the respective port via trucks and are therefore scaled at that port.

40. Logging crews harvest logs from forests using specialist plant and equipment. The logs are then transported to a central repository in the forest where they are organised for transportation either to a domestic processing mill, or to a port for export. This process is referred to as in-land marshalling. Firms such as Pedersen provide in-land log marshalling services. Logs that are to be sold in overseas markets are then transported to the nearest port for export.

Log Marshalling (port-side)

41. Log marshalling at a port has two aspects to it: scaling, and organising logs for loading onto vessels. Scaling is the process of measuring and ticketing logs to provide a volume measurement. Logs are measured by length and diameter and then a volume is calculated to find the Japanese Agricultural Standard (JAS) cubic metre measurement. After scaling, an electronic barcode is attached to the log, which includes details of the forest from which it originated, and its grade, quality, exporter, buyer and destination port.

42. The second aspect of log marshalling is moving and organising logs. When logs arrive at the port of export, the log marshaller assembles and stockpiles them ready for shipment. When the export vessel arrives, the log marshaller, in accordance with the shippers' instructions, arranges the logs under the hook of the ship's crane(s) so that they can be loaded onto the vessel by stevedores. This entire process is supported by electronic inventory management systems that prepare shipping summaries of logs loaded onto each vessel.

43. Specific requirements for log marshalling, such as the number and size of machines and the amount of labour required, depends on the individual characteristics of the port (for instance port lay-out and capacity). Regardless of the specific characteristics of the port, a log marshaller requires the following to operate:

- a specialised log marshalling information system that keeps an inventory of the logs. Industry participants advised that currently in New Zealand there are two specialist log marshalling systems available: LOGIS Limited's Logtrack and Jade Software Limited's log tracking system;

- machinery to carry and organise logs. These log-loaders are specially designed and built for log marshalling – they range in lifting capacity from 8-9 metric tonnes to 30 metric tonnes. On larger wharves, it is more efficient but not necessary to use large machines, for example Allied Wagners, which have the ability to lift up to 30 metric tonnes per load. However, at smaller ports or on wharves with less room, it is suitable to use smaller machines;

- sufficient specialised labour;

- access to ports. A log marshaller needs space at the port to enable scaling and organisation of the logs. Space to operate is allocated to marshallers by the port companies. With the exception of Tauranga (which has two log marshalling firms operating from it), all New Zealand ports have only one log marshaller. This is due partly to space constraints, but largely because the low volume of log cargo passing through these ports makes it uneconomic for multiple marshallers to operate. Centreport, for example, informed the Commission that there was not enough space to enable two log marshallers to operate at that port; and,

- access to sufficient log volumes to ensure log marshalling is commercially feasible.

Log Stevedoring

44. Log stevedoring is the loading and stowing of logs onto a ship, and the subsequent unloading of those logs from ships. Stevedores plan how to load a vessel and then load it using cranes.

45. Log stevedores ensure that vessels are safely balanced and efficiently loaded. This is usually organised portside using an IT system. Although there are specialist stevedore IT systems, ISO advised the Commission that it is possible to carry out basic stevedoring operations from an Excel spreadsheet.

46. Log stevedore labour can be highly specialised. Stevedore supervisors need to stow a vessel safely, while utilising the space to the best advantage. Log crane operators are also highly skilled specialists. Both types of employees are trained 'on the job'.

Other Industry Players

<u>Timber Investment Management Organisations (TIMOs)</u>

47. Since the Commission previously analysed these markets in Decisions 453 and 533, as outlined below, there has been a shift in the dynamics of the industry. Previously, forests were owned by firms that also exported and sold logs. The industry was also closely held, for instance in Decision 453 Fletcher Challenge Forests Limited and Carter Holt Harvey Limited had jointly comprised 90% of log exports. Ownership of the forests has changed significantly since that time. The main forest owners now are Timber Investment Management Organisations (TIMOs) such as Kaingaroa and Rayonier, which are United States investment consortiums. Forestry ownership is now considerably more fragmented with only one firm owning over 10% of the total forests. Table 1 illustrates present ownership of forest estates in New Zealand.

Table 1: New Zealand Planted Forest Ownership[8]

Owner	Planted area (hectares)	% of total
Carter Holt Harvey	221,000	12.04
Kaingaroa Timberlands	165,000	8.99
Rayonier	143,000	7.79
Hancock	107,000	5.83
Ernslaw One	86,000	4.69
Weyerhaeuser New Zealand	64,000	3.49
Juken New Zealand	55,000	3.00
Crown Forestry	42,000	2.29
Pan Pac Forest Products	32,000	1.74
Blakely Pacific	28,000	1.53
Other (11, plus farm forestry)	892,000	48.61
Total	1,835,000	100

Forestry operations management companies

48. Forestry operations management companies' primary purpose is to manage forests and the marketing and exporting of logs. Such companies have grown rapidly since the ownership of New Zealand forests have shifted towards TIMOs. Forestry operations management companies essentially manage under contract the estates of the forestry companies. Some forestry operations management companies restrict their activities to the marketing and export of logs, for example Pentarch and PFP, whilst others also manage forest rotations and harvesting, for example Rayonier. Major forestry operations management companies include: PFP, Pentarch, TPT, Timberlands and Pedersen.

49. Most forestry operations management companies that the Commission spoke to contract directly with the log stevedores and log marshallers. This means that log marshallers and stevedores do not have direct contact with the majority forestry owners (except for the forestry owners who also export logs).

Ports

50. Port structures in New Zealand vary between ports. Centreport and Port Taranaki are both subsidiary companies of their respective regional councils. Both operate as

[8] Source: Forestry Statistics Section, Policy Innovation and Research Group, Ministry of Agriculture and Forestry, *New Zealand Forestry Facts and Figures 2005/2006*, available on www.maf.govt.nz

commercial ventures, have commercial objectives and have control over the port hinterland.

51. The different ports have different agreements with log owners, log marshallers and log stevedores. Centreport [

]. Port Taranaki [

].

PREVIOUS COMMISSION DECISIONS

Northport Limited, Cease and Desist Order, 11 August 2006

52. On 11 August 2006 the Cease and Desist Commissioner issued a Cease and Desist Order against port owner Northport Limited and port services provider Northport Services Limited for activities at Marsden Point port near Whangarei. Both those parties had consented to the order. The Commission considered that Northport Limited had attempted to leverage its monopoly power as the port owner to exclude competition in the downstream market for port services.

53. The Commission considered that the relevant markets were the markets for:

- the provision of log marshalling services at Marsden Point port;
- the provision of general cargo marshalling services at Marsden Point port; and
- the provision of port infrastructural services at Marsden Point port.

Decision 533, Port of Tauranga / Toll Limited, 24 September 2004

54. On 22 June 2004, the Commission received an application for clearance by a yet-to-be formed joint venture company owned 50% by Port of Tauranga Limited and 50% by Toll Limited of all the shares in:

- The Owens Cargo Company Limited;
- Toll Logistics (NZ) Limited; and
- Leonard and Dingley.

55. The key issue the Commission investigated was vertical integration arising from the proposed acquisition. In particular, Decision 533 addressed the potential foreclosure in general cargo marshalling and stevedoring at Tauranga, and in log marshalling and stevedoring at Marsden Point, Tauranga, Gisborne, Napier and Lyttelton.

56. The Commission concluded that the majority of exporters would have a degree of countervailing power over the combined entity. Further, the Commission concluded that competition between operators at various ports would continue in the factual. Accordingly, the Commission concluded that the acquisition would not have, nor would be likely to have, the effect of substantially lessening competition.

57. In this decision the Commission considered the following markets:

- intermodal transport services in New Zealand between exporters/importers and ports;

- log marshalling at each port;
- log stevedoring at each port;
- general cargo marshalling at each port;
- general cargo stevedoring at each port;
- container handling in the North Island;
- container handling in the South Island; and
- port services within a region.

Toll Logistics (NZ) Limited (Toll Logistics) / Leonard & Dingley Limited, 26 May 2004

58. In January 2004, Toll Logistics acquired a 100% shareholding in Leonard & Dingley Limited, an Auckland stevedoring company. The acquisition also included a 50% shareholding in Auckland Stevedoring Company Limited.

59. The Commission investigated this acquisition under s 47 and found that the acquisition would not be likely to result in a substantial lessening of competition because Toll Logistics had no presence at the Port of Auckland before the acquisition.

60. The Commission considered the relevant markets were the provision of:

- marshalling services in general cargo at Auckland; and
- stevedoring services in general cargo at Auckland.

Decision 453, Port of Tauranga Limited / Owens Services BOP Limited, 8 February 2002

61. On 6 December 2001, the Commission received an application for clearance for Port of Tauranga to acquire 100% of the shares in Owens Services BOP Limited.

62. This acquisition involved two situations of vertical integration, namely Port of Tauranga’s entry into log marshalling and container servicing.

63. In the log related markets, the Commission considered that the threat of potential entry and the significant countervailing power of the two major forestry exporters would mean that the acquisition would not have, nor would be likely to have, the effect of substantially lessening competition.

64. In this decision the Commission considered the following markets:

- the provision of log marshalling services at Tauranga;
- the provision of port infrastructure for the export of logs from the CNI; and
- the provision of container maintenance and cleaning services at Tauranga.

MARKET DEFINITION

65. The Act defines a market as:

> "… a market in New Zealand for goods or services as well as other goods or services that as a matter of fact and commercial common sense, are substitutable for them."[9]

66. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximizing, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Log marshalling

Product Dimension

67. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.

68. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given and incentive to do so by a small change in their relative prices.

69. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

70. The Applicant submitted that the relevant product market is the provision of log marshalling services.

71. This is consistent with the Commission's findings in Decisions 453 and 533.

72. Log marshalling is an integral part of the supply chain – logs need to be measured, tagged and organised before they are loaded onto vessels and exported. In the face of a SSNIP, log exporters could not substitute any other service for log marshalling.

73. In previous Decisions, the Commission considered that log marshalling activities can be broken up into two categories and this position was supported by industry participants:

    - in-land log marshalling (including log scaling); and
    - at-port or wharf log marshalling (including log scaling).

[9] S 3(1) of the Commerce Act 1986.

74. Industry participants informed the Commission that the scaling component of log marshalling can occur either inland or at-port and where the scaling is done relates to how the logs are transported. Timberlands informed the Commission that logs that are trucked to ports will generally be scaled port-side, while logs shipped to port by rail are usually scaled in-land. Logs transported by rail are scaled in-land to build up volume and reduce congestion at the ports as there are usually storage facilities for logs at the log rail-heads. Logs transported by truck are picked up from harvest sites, where there are no storage facilities, and scaled at port-side.

75. All logs transported to the Port Taranaki or Centreport are transported via trucks, and therefore scaled at the port. Inland log scaling and rail transportation is not a consideration at these ports.

76. On the supply side, suppliers of similar services are general marshallers and log transport firms.

77. ISO informed the Commission that general marshallers use general inventory systems. The Commission investigated whether the general marshalling systems could be used for log marshalling.

78. QM advised the Commission that log marshalling requires specialised equipment and information systems. In addition, QM stated that log marshalling systems are complicated as every log is different and needs to be recorded as such. Log inventory systems record the forest, grade, quality, exporter, buyer and destination port. ISO informed the Commission that due to the complexity of the information, a specially built system is needed. [ ] On the other hand, [ ] considered that it could adapt its general marshalling system to log marshalling relatively easily. However, [ ].

79. The Commission considers that general marshallers would have to invest in specialised information systems or invest significantly to adapt their general marshalling system to switch into log marshalling. As these inventory systems can only be utilised for the marshalling of logs, this investment is largely sunk. On balance, due to the need to invest in sunk costs, the Commission does not consider general marshallers to be supply-side substitutes for log marshallers.

80. The Commission also considered whether in-land log marshalling firms and log transport firms are supply side substitutes for log marshalling. In-land log marshalling firms and log trucking firms operate similar machinery to port log marshallers. In-land log marshallers advised the Commission they do not use the scaling inventory systems. [ ] informed the Commission that it had the necessary machinery [ ].

81. [ ] stated that it did not have the specialist machinery necessary to undertake port log marshalling namely an Allied Wagner. [ ] stated that an off-the-shelf information system could be purchased at a cost of approximately [ ].

82. The Commission tested the assertion, regarding the cost of log marshalling information systems, with LOGIS Limited and Jade Software Limited, the only two IT firms that

currently develop log marshalling software. Both these suppliers indicated that an off-the-shelf inventory control system would cost approximately [ ].

83. In-land log marshallers and log trucking firms would need to invest in information systems to switch into port log marshalling. On balance, due to the need for this additional investment, the Commission considers that there is limited supply side substitution possible between in-land marshalling firms / log transport firms and log marshallers.

84. The Commission also considered whether log stevedores and log marshallers are in distinct markets. In previous Decisions, the Commission considered there to be separate markets for log marshalling and log stevedoring. Industry participants supported the Commission's previous position, stating that there continues to be no real overlap between log stevedoring and marshalling. Log stevedoring and marshalling involve different labour skill sets, different machinery and different information systems.

85. ISO advised the Commission that there is no cross-over in the usage of labour between log marshalling and log stevedoring as the high intensity periods of work for both activities coincide – when a vessel is at wharf-side for loading, and hence neither service has spare labour capacity.

86. Due to these factors the Commission considers that in this case log marshalling and log stevedoring are in distinct markets.

87. Accordingly, the Commission considers that the relevant product market is:

- the provision of at-port log marshalling services.

Functional Dimension

88. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

89. The Commission considers that, for the purposes of this Application, the product market can also be considered the equivalent of the functional level, as the products are service provisions along the same chain, namely the provision of the following services:

- log harvesting;
- in-land log marshalling;
- log transport (either rail or truck);
- port log marshalling; and
- log stevedoring.

90. Accordingly, the relevant functional markets are the provision of log marshalling services.

Geographic Dimension

91. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

92. The Applicant submitted that the relevant geographic markets are port specific, namely:

- Centreport (Wellington); and
- Port Taranaki (New Plymouth).

93. This is consistent with the Commission's previous decisions.

94. Log marshalling requires heavy machinery that cannot be moved from port to port quickly without incurring significant cost. A marshaller at a port will invest in machinery that normally will remain at that port.

95. Industry participants consistently advised the Commission that logs are transported to the closest port. There are 13 ports in New Zealand, (of which, 12 handle logs), and these are geographically quite distant from one another. Hence, the diversion of log volumes from one port to another would involve substantial transport costs, which would easily overwhelm the savings made by avoiding the SSNIP.

96. Tasman Bay informed the Commission that the Port of Nelson generally covers the Golden Bay region and Port of Marlborough approximately covers the Marlborough region. Tasman Bay stated that there is a point about half-way in the Wairau Valley from where the logs can be transported to either Picton or Nelson.

97. Pentarch stated that exporters select ports based on proximity to the forests and that the costs of log marshalling are minimal in comparison to transport costs. Hence, even in the face of a SSNIP it would be unprofitable to transport logs to another port. Southern Cross advised the Commission that logs naturally go to the nearest port.

98. [

]

99. This analysis is consistent with what industry participants considered and supports the Commission's previous Decisions that log marshalling is port specific as there is little scope to economically switch log volumes between ports in response to a SSNIP. In a few instances, forest estates are roughly equidistant between two ports, and in such cases, the exporter has some choice regarding which port to utilise. However, in the majority of cases, exporters have little choice about where logs are exported from, so the logs are transported to the nearest port.

100. Accordingly, the Commission considers that the geographic markets are port specific and the relevant ports are:

- Centreport; and
- Port Taranaki.

Conclusion on log marshalling

101. The Commission considers the relevant markets to be:

- the provision of log marshalling services at Centreport; and
- the provision of log marshalling services at Port Taranaki.

Log stevedoring

102. The proposed acquisition would not change the market shares of companies involved in log stevedoring at either Centreport or Port Taranaki, as there is no horizontal aggregation in log stevedoring arising at either of these ports. However, due to the vertical integration which would occur in the factual in relation to log marshalling and log stevedoring, the Commission considers it appropriate to also consider the log stevedoring market.

Product Dimension

103. On the demand side, there are no substitutes for log stevedoring services as logs need to be loaded onto the vessels by cranes for export.

104. On the supply side, the closest suppliers of similar services are general stevedores. The Commission investigated whether general stevedores could switch into log stevedoring easily, quickly and with little cost, given a profit incentive.

105. ISO stated that [ ]. Southern Cross stated that log stevedoring is a skilful job and that "there is quite an art to it".

106. On this basis, the Commission considers that general stevedores cannot switch to log stevedoring easily and quickly in the face of a SSNIP, and therefore considers that there is no scope for supply side substitution. Accordingly, the Commission considers that the relevant product market is:

- log stevedoring.

Functional Dimension

107. As discussed above in relation to log marshalling, log stevedoring is part of a service chain and the product market can also be considered as the functional level. Therefore, the Commission considers the relevant functional dimension is:

- the provision of log stevedoring services.

Geographic Dimension

108. The geographic demand-side considerations for log stevedoring are identical to those for log marshalling (see paragraphs 91-100). The Commission considers that log stevedoring is also port specific as there is little scope for log exporters to economically switch log volumes between ports in response to a SSNIP.

109. Stevedoring tends to be port-specific, but it is a labour-intensive activity with little equipment requirements. Cranes used in log stevedoring are attached to the ships.

110. At Centreport, there are two permanent log stevedores: ISO and Toll Owens.

111. At Port Taranaki, Toll Owens does not have a permanent log stevedore labour force. Accordingly, it either transports staff to the port or sub-contracts the stevedoring work to Southern Cross Stevedores, which does have a presence in Port Taranaki. Toll Owens advised that [ ].

112. Toll Owens advised the Commission that it wishes to maintain TPT (the sole log exporter at Port Taranaki) as a customer on a national basis. Although TPT only exports [ ] cubic metres of logs from Port Taranaki, it exports [ ] tonnes nationally. Toll Owens currently stevedores approximately [ ]% of TPT's logs nationally. Toll Owens considers stevedoring in Port Taranaki as part of its relationship with TPT.

113. ISO stated that it [ ]. Tasman Bay stated that it [ ].

114. It appears that the main reason for flying labour into a port is to preserve a relationship with a large customer where the stevedore does not have a presence at a particular port. A SSNIP would therefore not be sufficient to induce suppliers to switch or expand into new ports; competition between stevedores is port specific.

115. Accordingly, the Commission considers that the relevant geographic markets are:

- log stevedoring at Centreport; and
- log stevedoring at Port Taranaki.

Conclusion on Market Definition

116. The Commission considers the relevant markets to be:

- the provision of log marshalling services at Centreport;
- the provision of log stevedoring services at Centreport;
- the provision of log marshalling services at Port Taranaki; and
- the provision of log stevedoring services at Port Taranaki.

COUNTERFACTUAL AND FACTUAL

117. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement

considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).[10]

118. The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

119. In the relevant factual scenario, at Centreport and Port Taranaki, Toll Owens would acquire the log marshalling assets of John Ray, and accordingly would be the sole provider of log marshalling services at these ports.

120. No horizontal aggregation in log stevedoring arises as a result of this acquisition. Therefore it is likely that Toll Owens would be the sole provider of log stevedoring at Port Taranaki and compete in log stevedoring with ISO (which currently handles approximately [ ]% of the volume) at Centreport.

Counterfactual

121. John Ray advised the Commission that if the acquisition did not proceed, it would continue to provide log marshalling and log stevedoring services in Centreport and Port Taranaki. John Ray also operates other businesses, including an earth excavation business in Wellington and a part share in the Waitane Sawmill. These businesses are not affected by the acquisition and would continue to operate in both the factual and the counterfactual. [

].

122. Accordingly, in the absence of the acquisition by Toll Owens, the Commission considers that the most likely counterfactual scenario would be the continuation of the status quo.

COMPETITION ANALYSIS

Log Marshalling at Centreport and Port Taranaki

Existing competition

123. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

124. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

125. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situation exist:

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[10] Air New Zealand & Qantas Airways Ltd v Commerce Commission (No.6), unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected persons or associated persons) has less than in order of 40% share; or
- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

126. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

127. Table 2 details current market share information for log marshalling at Centreport and Port Taranaki. These market shares are based on the total volumes in tonnes submitted by the Applicant, John Ray, Port Taranaki, Centreport and exporters through the two ports.

Table 2: Centreport and Port Taranaki market shares for log marshalling

Company	Location	cubic metres	Market share %
Toll Owens	Centreport	0	0
John Ray	Centreport	[ ]	100
Combined entity	***Centreport***	***[ ]***	***100***
Toll Owens	Port Taranaki	0	0
John Ray	Port Taranaki	[ ]	100
Combined entity	***Port Taranaki***	***[ ]***	***100***

128. As the markets for log marshalling are defined as port specific, the proposed acquisition would not result in any horizontal aggregation – rather there would be a bare transfer of an existing market position from John Ray in the counterfactual to Toll Owens in the factual. This was recognised by numerous significant market participants, for example CCH and TPT. In the counterfactual, John Ray would remain the sole provider of log marshalling services in Centreport and Port Taranaki; whilst in the factual, Toll Owens would be the sole provider of log marshalling services in these two ports.

129. The proposed acquisition would result in vertical integration at both Centreport and Port Taranaki, due to Toll Owens' existing stevedoring operations at both ports. This will be dealt with in the *Vertical Integration* section in the report (paragraphs 147-179).

Potential Competition

130. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try.

<u>John Ray as a potential entrant into other ports</u>

131. In Decision 533 the Commission considered John Ray as a likely entrant in the provision of log marshalling services at the POT. The Commission has re-assessed whether this is still the case, and hence, whether the acquisition removes a potential entrant into other log marshalling markets (i.e, log marshalling services at other ports).

132. John Ray advised the Commission recently that [ ].

133. John Ray also advised the Commission that [ ].

134. Northport was a sealed bid tender, and whilst other industry participants were generally aware that John Ray submitted a bid after the fact, John Ray's status as a bidder was not known to other participants at the time the bids were submitted. The Commission considers it unlikely that John Ray's presence impacted on rivals' bids.

135. John Ray advised the Commission that it had considered entry into Picton a number of years ago, [ ].

136. Not a single industry participant spoken to by the Commission considered John Ray to be a likely entrant into other ports and a number of industry participants outside the Wellington and Taranaki regions, for example Kaingaroa, did not know of John Ray's existence.

137. Industry participants, including competitors to Toll Owens, advised the Commission that they do not consider John Ray to be a likely entrant, and therefore do not see it as a constraint, on log marshallers at other ports. John Ray is a small, privately-owned company looking to rationalise its operations. Although John Ray operates at two ports, Centreport and Port Taranaki, volumes in Port Taranaki are very small.

138. Industry participants view QM as the major constraint on Toll Owens, as it operates at Tauranga (by far the largest forestry export port in New Zealand), is willing to enter into other ports, marshals a large volume of logs, has a good reputation and has what many industry participants consider to be the best inventory management system.

139. No industry participants mentioned John Ray as an option when considering potential log marshallers at New Zealand ports other than Centreport and Port Taranaki.

140. On balance, the Commission concludes that John Ray is not considered to be a likely competitor for the log marshalling operations at ports other than Centreport and Port Taranaki, and is not a constraint on the log marshalling operations at other ports. The Commission accordingly considers that this proposed acquisition would not result in the loss of a potential entrant and therefore, there is no difference between the factual and counterfactual regarding existing and potential competition in log marshalling at other ports.

Comparison of potential entry in the factual and the counterfactual

141. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry.

142. The Commission assessed whether there would be a substantial change in the competitive constraint imposed by likely entry into log marshalling in the ports of Centreport and Port Taranaki between the counterfactual and the factual.

143. The Commission identified several requirements that need to be satisfied in order for entry to occur into the marshalling markets (as previously discussed in the Industry Background section). The Commission assessed whether there would likely be any change in entry conditions under the factual compared with the counterfactual:

- heavy machinery to load the logs - there would be no difference between the counterfactual and the factual, as in both scenarios a new entrant would need to acquire the same heavy machinery to provide log marshalling services;
- labour to operate the machinery - there would be no difference between the counterfactual and the factual, as in both scenarios a new entrant would need to hire labour to operate the machinery to provide log marshalling services;
- access to the port, required to enable scaling of the logs and to conduct log marshalling - there would be no difference between the counterfactual and the factual, as in both scenarios a new entrant would need to gain access to the port to provide log marshalling services;
- volume requirements (i.e, securing customer contracts with sufficient volume) - there would be no difference between the counterfactual and the factual, as in both scenarios a new entrant would need to secure customer contracts with sufficient volume in order to make it commercially feasible to provide log marshalling services; and
- an inventory control system to track and monitor movement. Industry participants, for example [

  ]. This may be a slight increased barrier to entry, as a potential entrant's information system in the factual would be compared with Toll Owens' system, which is superior to John Ray's system in the counterfactual. The Commission notes this would not be an issue if QM were to be the potential entrant, as it already has a log inventory control system.

144. Industry participants advised that due to space constraints and volume requirements, a new entrant would need to replace the incumbent (at current log volumes), as there is insufficient space or volume for two log marshallers (except at Tauranga). Industry participants advised that between 100,000 and 500,000 cubic metres of logs would be required to sponsor entry. This would remain the same in the factual and counterfactual.

145. The Commission assessed whether there would be any difference in strategic barriers between the factual and the counterfactual. Strategic barriers may arise from the established positions of incumbent businesses, and their acting intentionally in such a way as to discourage prospective entrants. Industry participants advised that it is not likely that Toll Owens would have any strategic advantage in the factual compared with John Ray in the counterfactual. [ ].

146. On the basis of the preceding discussion, the Commission considers that there is no significant difference in the entry conditions for log marshalling to either market Centreport and Port Taranaki, between the factual and the counterfactual.

Vertical Integration

147. Vertical acquisitions are those that involve businesses operating at different functional levels in the production of a particular good or service.

148. The Commission is of the view that, in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless market power exists at one of the affected functional levels. Where such a situation is found to exist, the Commission considers whether the acquisition would strengthen that horizontal position, or have vertical effects in upstream or downstream markets, and whether that change would substantially lessen competition.

149. The proposed acquisition would link all the log marshalling and log stevedoring services at Port Taranaki, as well as linking all the log marshalling and log stevedoring services at Centreport not provided by ISO. The Commission has focused on whether the vertical integration resulting from the acquisition would substantially lessen competition in the relevant markets.

150. Table 3 details log stevedoring work at Centreport and Port Taranaki. These market shares are based on the total volumes (in tonnes) submitted by the Applicant, Centreport, Port Taranaki and exporters through the two ports.

151. There is no aggregation in log stevedoring resulting from the acquisition.

Table 3: Centreport and Port Taranaki log stevedoring market shares

Company	Location	Cubic metres	Market share %
Toll Owens	Centreport	[ ]	[ ]

ISO	Centreport	[ ]	[ ]
Total market	***Centreport***	***[ ]***	***100***
Toll Owens	Port Taranaki	[ ]	100

152. Under the factual and counterfactual, at Port Taranaki, Toll Owens is the sole provider of log stevedoring services. However, [ ]

153. Under the factual and counterfactual, at Centreport, Toll Owens would be likely to have a [ ]% market share and ISO would be likely to have a [ ] market share of log stevedoring.

154. The Commission notes that the impact of the acquisition, whereby Toll Owens supplies both the log stevedoring and log marshalling services, does not amount to classic vertical integration in the usual sense. There is no upstream firm that provides an essential intermediary input to a downstream affiliate. This is because both log marshallers and log stevedores contract directly with the exporter (the 'end-user'), and whilst the exporter relies on both their services, the marshallers and stevedores do not rely on each other's services as an input (although they each do need the other to be efficient in order to operate and compete). This means a number of the concerns that could arise when vertical integration occurs do not arise with this particular acquisition.

155. The Commission has considered whether the vertical integration raises any competition concerns[11], as discussed below.

Increased entry barriers

156. The Commission has considered whether the vertical integration in the factual would raise the barriers to entry by requiring an entrant in one market (either marshalling or stevedoring) to simultaneously enter into the other market. Such a requirement would only exist to the extent that buyers (exporters) find it profitable to purchase both marshalling and stevedoring services as a 'bundle' from the same supplier.

157. Most log exporters expressed a strong preference for obtaining unbundled services for log marshalling and log stevedoring [ ]. Industry participants advised the Commission that it was common practice to request separate quotes for log marshalling and log stevedoring services, to enable them to evaluate and benchmark against the costs of services at other ports. [ ] advised the Commission that Toll Owens had provided it with a bundled quote for log marshalling and log stevedoring services at Tauranga, but [ ] requested separate

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[11] Commerce Commission, *Mergers and Acquisitions Guidelines, January 2004*, page 36 and also see *U.S. Department of Justice and the Federal Trade Commission Horizontal Merger Guidelines, 8 April 1997*, pages 24-30.

quotes for the two services, which it received, and that [ ] used two separate providers in that instance.

158. TPT advised the Commission that it sought a detailed Request for Proposal (RFP) for the services it required across all ports in New Zealand, and that it selected the best providers based on [

].

159. [ ] advised the Commission that it was particularly "keen to see the port, marshalling and stevedoring companies operate independently" as it enabled [ ] to get a "clear idea of costs of each part of the operation". [ ] advised that it had a "healthy cynicism of companies providing both services" and took explicit steps to avoid it.

160. [ ] stated that it did not consider there to be any economies of scope from having an integrated log marshalling and log stevedoring service and that it had not been offered a bundled service to date.

161. Industry participants advised the Commission that in some instances there may be slight efficiencies in having one service provider for both log marshalling and log stevedoring; however there is little overlap in the services provided as the cost savings (from reduced transaction costs and economies of scope), if any, were minor. [ ].

162. Log exporters [ ] advised the Commission that they weighed up any possible savings from having one provider against the transparency and service benefits of having separate providers, and advised that they strongly preferred unbundled services. [ ] advised the Commission that it would continue using [

].

163. In addition, customers noted that having separate providers for log marshalling and log stevedoring allowed them to cross check and reconcile log volume, grade and customer data from the service providers, as it allowed audit of the cargo being handled by various suppliers along the service chain. This was seen as a significant benefit from industry participants. One customer, [ ], advised that having separate providers for log marshalling and log stevedoring services was an added security as it "eliminated risks" regarding incorrect volumes and was a way of "keeping both service providers honest".

164. Industry participants recognise log marshalling and log stevedoring as separate functions and as such, there is no need for an entrant to provide both services. Industry participants consistently advised that they prefer separate providers.

165. The Commission assessed the log marshalling and log stevedoring service providers used by exporters at various ports around New Zealand, and considers that an exporter's use of an integrated service is an exception rather than the norm. The Commission considers that the use of an integrated service usually occurs for reasons

other than efficiency, for example, [ ] considered the key factor at [ ] to be the reputation of Toll Owens' staff . In addition, Toll Owens provided a very good stevedoring service at [ ] and [

].

166. Given exporters' strong preference for an unbundled service, the Commission considers that under the factual, it would not be necessary to enter both log marshalling and log stevedoring markets simultaneously. Therefore barriers to entry in this respect would be the same in the factual and the counterfactual.

Toll Owens' ability to leverage its position in log marshalling to strengthen its position in log stevedoring

167. The Commission has assessed whether Toll Owens, in the factual at Centreport, would have the ability to leverage its position in log marshalling to strengthen its position in log stevedoring.

168. The Commission specifically assessed the ability of Toll Owens, as the sole log marshaller at Centreport, to only provide its log marshalling services on the basis that its customers also must use Toll Owens' log stevedoring services.

169. [

]

170. The ability for an exporter to 'set up' a log marshaller is discussed in this paper under Countervailing power in paragraphs 180-206.

171. Industry participants advised the Commission that at present many ports around New Zealand offer the services of only one log marshaller (often Toll Owens), and two log stevedores (Toll Owens and usually ISO), and that Toll Owens has not, to date, attempted to leverage its position in log marshalling into log stevedoring.

172. Exporters have advised the Commission that, as there is no evidence of exclusionary conduct by Toll Owens at other ports around New Zealand, they do not see it as likely that Toll Owens would attempt to do this in Wellington.

173. Due to exporters' strong preference for an unbundled service, the degree of constraint of log exporters, and given there is no evidence of Toll Owens engaging in exclusionary conduct in the past, the Commission considers that, in the factual scenario, it would be unlikely that Toll Owens would be able to leverage its position in log marshalling to strengthen its position in log stevedoring at Centreport.

Facilitation of co-ordination effects

174. Facilitation of co-ordination effects is where the efforts of a group of upstream firms to collude may be undermined by competition between downstream firms. Such an effect may be prevented if there is vertical integration between all upstream and downstream firms. ISO and QM, which compete vigorously with Toll Owens in log stevedoring and log marshalling respectively, remain un-integrated in the factual and therefore vertical integration is unlikely to facilitate collusion.

Foreclosure of entry

175. This concern relates to firms tying up supply channels by vertically integrating with a downstream purchaser, thereby excluding competitors from the market. In this case, log exporters and log stevedores each contract directly with the exporter, and as such there is no ability for either log marshaller or log stevedore to foreclose entry into either market, as it is the relationship with the exporter which is essential for entry.

Access concerns

176. This relates to the ability of a vertically integrated firm to restrict access to an essential facility or intermediary input that down stream competitors require in order to compete.

177. Industry participants have advised that there is no ability for either a log marshaller or a log stevedore to restrict access to essential facilities, because log marshallers do not supply an input as such to the downstream stevedore, but rather a service directly to exporters (the end users). The only area where an access concern could potentially arise is in the flow of information between log marshallers and log stevedores relating to the description of the log cargo. Industry participants advised they were unaware of any past instances where access to necessary information had been a concern, and that they considered it very unlikely that Toll Owens would restrict the flow of information to competing stevedoring firms in order to give their own stevedoring business a competitive advantage.

178. The Commission is of the view that it is unlikely that either log marshallers or log stevedores would prevent the flow of information required, because to do so would impact on the service provided to their customers. In addition, their customers might well react strongly to such behaviour, see the following section on Countervailing Power.

Conclusion on vertical integration

179. On the basis of the preceding discussion, the Commission concludes that, compared to the counterfactual, the vertical integration resulting from the proposed acquisition would be unlikely to give rise to a substantial lessening of competition.

Countervailing power

180. The potential for a business to wield market power may be constrained by countervailing power in the hands of its customers, or when considering buyer market power (oligopsony or monopsony) by its purchasers. In some circumstances, this constraint may be sufficient to eliminate concerns that an acquisition would be likely to lead to a substantial lessening of competition.

181. The Applicant argued that exporters exert considerable countervailing power over log marshallers and log stevedores. The Applicant submitted to the Commission that should a large forestry exporter wish to change log marshaller or log stevedore, that "it is feasible simply to establish an entity precisely for that purpose."

182. The Commission canvassed this issue with a number of log exporters, including CHH, Kaingaroa, Rayonier, Pentarch, PFP and TPT. They consistently advised the Commission that the predominant constraint on log marshallers and log stevedores

(under both the factual and counterfactual) would be the countervailing power of exporters. Exporters advised that if they were unhappy with the service provided by a log marshaller or if Toll Owens attempted to increase marshalling rates post acquisition, they would consider setting up an alternative log marshaller, or 'sponsoring new entry'.

183. Access to log volumes is a key factor in determining the success of entry; without customers' support entry cannot occur, which is why 'sponsoring' is required.

184. Log exporters informed the Commission that 'sponsorship' would involve a preferred supplier contract between an exporter and new entrant (either an existing log marshaller, for instance QM, or a totally new player, for instance Rotorua Forest Haulage or ISO).

185. There is a history of sponsored entry in this area. In 1991, CHH was not satisfied with the service it was receiving from Owens Services BOP Limited (now Toll Owens), and so invited a trucking contractor to set up a competing marshalling operation. As a result, the Lambert Group formed QM and it has been marshalling logs through Tauranga since that time.

186. The nature of this 'sponsorship' was a [ ]. CHH is currently disposing of its forestry assets [ ].

187. [ ] advised the Commission that it would consider sponsored entry by partnering with a stevedore company or a port company. In addition, [ ].

188. [ ] advised the Commission that if its relationship with the log marshaller was "not working", it would bring someone else in, for instance [ ]. [ ] informed the Commission that when it [ ]. However, [ ] advised the Commission that a log marshaller would have to perform poorly over a prolonged period before it would consider sponsoring entry.

189. [ ] advised the Commission that if there were difficulties with Toll Owens in the factual, it would either stop exporting from a particular port or use someone else, which it considered to be a "relatively simple process".

190. [ ] advised the Commission that there is some threat of replacement over log marshallers, while [ ] advised the Commission that sponsorship was feasible but could not be done overnight.

191. The Commission recognises there are difficulties in sponsoring a new entrant, which could possibly diminish any countervailing power of exporters. Industry participants advised the Commission that these difficulties include that:

- the new entrant would need sufficient volumes to justify entry;
- the new entrant would need access to ports; and

- a new entrant would need to overcome logistical difficulties such as securing contracts with a number of different exporters at a port.

192. Industry participants had differing views as to the level of sufficient volume that would be required to sponsor entry. [ ] informed the Commission that it considered outlying ports, such as Lyttelton and Gisborne, would be too small to warrant sponsored entry. Likewise, [ ] both considered they would need [ ] cubic metres of logs to sponsor entry. [ ] considered it would need [ ] cubic metres of logs to justify sponsoring entry, whereas [ ] cubic metres of logs would be sufficient to justify entry. These volumes would indicate that Centreport and Port Taranaki (with volumes of [ ] and [ ] cubic metres respectively) are too small to be able to sponsor entry.

193. However, other log exporters considered that these two ports need to be viewed in the context of the New Zealand industry as most log exporters export from more than one port. These industry participants considered that while log marshalling and log stevedoring services contracts are port specific, Toll Owens operates at most ports and therefore needs to maintain relationships across a number of ports.

194. [ ] advised the Commission that it has a relationship with Toll Owens nationally, as well as at individual ports [ ], which it considers strengthens its position against Toll Owens, as Toll Owens would be unlikely to misbehave at one port for fear of jeopardising its relationships at other ports.

195. Although in the Commission's view log marshalling markets are best considered as specific to each port, some exporters also considered that they had enough volume across a number of ports to attract a new entrant. For instance, [ ] considered that it has enough volume across all the ports it operates at to justify a new entrant.

196. On balance, the Commission considers the need for Toll Owens to maintain relationships across the board means that the small log volumes at Centerport and Port Taranaki would not materially diminish log exporters' countervailing power.

197. Industry participants also considered that gaining access to ports would be a potential difficulty as most do not have sufficient space for two log marshallers to operate simultaneously. Centreport advised the Commission that its port is not big enough for more than one log marshaller. This means that any sponsored entrant would have to replace the incumbent.

198. Centreport further advised the Commission that if a log marshaller such as Toll Owens was to try to abuse its market power to the detriment of the exporters, [ ].

199. Port Taranaki advised the Commission that there was not enough space at the port for another log marshaller. [ ].

200. Ports have a commercial incentive to make port visits by shipping firms (contracted by exporters) as attractive as possible. Rising export costs (which comprise, among other things, log marshalling expenses) or a drop in service quality, may deter exporters' patronage of the port.

201. The Commission considers that due to the ports' commercial incentive to co-operate with the exporters, this access barrier would be likely to be overcome, as both exporters and ports would want to have an effective log marshaller in operation at the port and would work towards this.

202. Due to the fact that Centreport can only accommodate one log marshaller, and that Port Taranaki would prefer to have only one, and that this is widely held industry knowledge, the Commission assessed the impact of this on sponsored entry.

203. Since there may be several exporters operating out of these two ports,[12] it may not be a credible threat for one buyer alone to threaten to sponsor entry or switch to a new supplier; all buyers or the majority of buyers may need to switch for the threat to be credible. This requires an element of co-ordination / co-operation between exporters, which themselves are in competition with one another.

204. The exporter operating out of Port Taranaki is [ ], whilst the major exporters operating out of Centreport are [ ].

205. [ ] stated that if a larger player wanted to sponsor entry at a port, the smaller players would be likely to follow its lead. [ ] advised the Commission that they would switch to use the services of a new log marshaller if approached with such a proposition from another exporter out of [ ], purely to keep Toll Owens in check. [ ] advised the Commission it would switch to a new log marshaller even if it was satisfied with the services it received from the existing log marshaller, to pre-empt any such move Toll Owens might make against that exporter in the future. Accordingly, the Commission considers that the difficulty in coordinating sponsored entry by exporters is one which could be overcome, and as such, does not consider this to materially diminish the countervailing power of exporters.

206. On the basis of the above discussion, the Commission concludes that the threat of sponsored entry would be likely to offer constraint on the log marshalling operations of Toll Owens at Centreport and Port Taranaki in the factual scenario.

OVERALL CONCLUSION

207. The Commission has considered the probable nature and extent of competition that would exist subsequent to the proposed acquisition in the markets for log marshalling and log stevedoring at Centreport and Port Taranaki (the factual), as compared with the status quo (the counterfactual).

208. The proposed acquisition would not result in any horizontal aggregation given that John Ray and Toll Owens currently operate in separate geographic port markets. Rather, a bare transfer of an existing market position from John Ray to Toll Owens would result, such that Toll Owens would be the sole provider of log marshalling services at these two ports.

[12] The Commission notes that currently there is only one export company [ ], operating out of Port Taranaki.

209. There is presently no existing competition in either port market, and post acquisition there would still be no existing competition, although the identity of the incumbent would be different.

210. John Ray is not considered by industry participants to be an effective competitor or a constraint on log marshalling operations at other ports and accordingly the Commission is of the view that the proposed acquisition would not result in a loss of a potential entrant into New Zealand port markets other than Centreport and Port Taranaki.

211. Toll Owens, as the incumbent in the factual at Centreport and Port Taranaki in the place of John Ray, does not significantly raise the barriers to entry in the factual compared to the counterfactual.

212. The Commission has focused its analysis on the vertical integration resulting from the proposed acquisition:

- Toll Owens would be the sole provider of both log marshalling and log stevedoring services at Port Taranaki; and
- Toll Owens would be the sole provider of log marshalling at Centreport, and both Toll Owens and ISO would provide log stevedoring services.

213. The Commission considers that the vertical integration in these ports, under the factual, is unlikely to raise significant competition concerns, due to the following factors:

- exporters' strong preference for unbundled log marshalling and stevedoring services;
- exporters' ability to separate log marshalling and log stevedoring services, by requesting those services separately and by their ability to benchmark the cost of these services across port markets; and
- the fact that log marshallers and log stevedores contract directly with exporters as opposed to contracting with one another.

214. The Commission also considers that the threat of sponsored entry would be likely to offer constraint on the log marshalling operations of Toll Owens at Centreport and Port Taranaki in the factual scenario.

215. Due to the above, the Commission concludes that the proposed acquisition would not result, or would not be likely to result, in a substantial lessening of competition in the markets for log marshalling and log stevedoring at Centreport and Port Taranaki.

DETERMINATION OF NOTICE OF CLEARANCE

216. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Toll Owens Limited of the log marshalling assets of John Ray Limited.

Dated this 11th day of October 2006

Paula Rebstock
Chair
Commerce Commission