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COMMERCE COMMISSION

Decision No. 415

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

PaperlinX Limited

and

Spicers Paper Limited

The Commission: M J Belgrave (Chair)
M N Berry
E C A Harrison

Summary of Proposed Acquisition: PaperlinX Limited seeks clearance to acquire the remaining 58% of the shares in Spicers Paper Limited.

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

Date of Determination: 20 December 2000

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THE PROPOSAL

1. On 1 December 2000, the Commission registered a notice ("the Application") pursuant to section 66(1) of the Commerce Act 1986 ("the Act") seeking clearance by PaperlinX Limited ("PaperlinX") to acquire the remaining 58% of the shares in Spicers Paper Limited ("Spicers"). The proposal will take the shareholding of PaperlinX in Spicers to 100%.

THE PROCEDURES

2. Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of five working days was sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the Application is due no later than Friday 22 December 2000.

3. The Applicant sought confidentiality for specific information contained in the notice, and a confidentiality order was made in respect of this information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's determination is based on an investigation conducted by its staff. In the course of the investigation Commission staff obtained further information from the Applicant; paper merchants; printers; office product retailers; converters; mill agents; office equipment manufacturers; stationery retailers; the New Zealand Printing Federation and the Ministry of Economic Development.

THE PARTIES

PaperlinX

5. PaperlinX is a holding company for Paper Australia Pty Limited ("Paper Australia") and PaperlinX Investments Pty Limited ("PaperlinX Investments").

6. Paper Australia is a manufacturer of fine papers, and maintains a representative office in New Zealand. The function of this office is to facilitate the sale of paper manufactured in Australia by Australian Paper. It does not handle customer orders.

7. Paper Australia is also the holder of PaperlinX's 41.1% shareholding in Spicers.

8. PaperlinX Investments is the holding company for a group of international paper trading companies ("Pacific Paper Marketing"), and also for a group of international raw material trading companies ("Amtrade").

9. PaperlinX operations in New Zealand are through PaperlinX (NZ) Limited, which operates three businesses- Dalton Fine Paper (New Zealand), a paper merchant business; Pacific Paper Marketing (New Zealand), a paper trading business; and Amtrade (New Zealand), a raw materials business.

10. The structure of the PaperlinX companies operating in New Zealand is shown diagrammatically in Appendix 1.

Spicers

11. Spicers operate paper merchanting businesses in New Zealand, Australia, Asia and North America. It distributes fine papers which it sources from Europe, North and South America, Asia and Australia. In addition, Spicers also manufactures and distributes paper-based stationery products.

12. In New Zealand, Spicers operates through its wholly owned subsidiaries, Spicers Paper (NZ) Limited, and Armitron Paper Limited. Edwards Dunlop (NZ) Ltd and Paper Associates (NZ) Ltd are not active companies in New Zealand.

13. The structure of the Spicers companies operating in New Zealand is shown diagrammatically in Appendix 1.

BACKGROUND

Other Relevant Parties

14. Other national merchants include BJ Ball Papers, CPI Papers (NZ) Ltd and British and Foreign Papers Ltd (“B&F”).

15. Original equipment manufacturers, such as Canon (NZ) Ltd and Fuji Xerox NZ Ltd, also distribute paper sourced from overseas.

16. Mill agents are usually represented in the region and act for an overseas mill, and arrange for supply to merchants and end users on a commission basis (eg Pacific Paper Marketing).

17. In addition there are a number of other parties including printers and converters (eg Croxley). Converters are businesses who manufacture rolls and sheets of paper into branded stationery lines.

Paper Distribution

18. Fine paper comprises of a wide range of printing, writing and stationery papers that are sold in cut sizes, sheets and reels.

19. In 1991 New Zealand Forest Products decided to cease the production of printing and writing grades of paper at the Kinleith mill, leaving only a minor production capacity at Mataura in the South Island. Prior to the Mataura plant being mothballed, in August 2000, it was producing watermark and letterhead bonds.

20. Imports of fine paper into New Zealand have continued to grow, rising at an average rate of 10.6% per annum.[1] Paper is the most rapidly growing sector of New Zealand imports of forest products. Fine paper is imported from Australia, Brazil, Indonesia, South Africa, USA, Germany and other countries.

21. Tariffs on fine papers have been steadily declining since 1988. The Ministry of Economic Development advised that tariffs are expected to be nil (subject to a WTO agreement) by January 2004. Some tariffs remain for a small range of fine paper products, but for the high-volume fine papers (eg A4 office paper) there has been no tariff, effective from 1 September 2000.

[1] Ausnewz Pulp & Paper Year Book 2000.

22. Paper merchants distribute paper sourced from fine paper manufacturers throughout the world. The paper is shipped to New Zealand, and transported to merchants' warehouse facilities, to be sold and delivered to customers. Paper is transported using a combination of road and rail transport.

23. Paper merchant's onsell a variety of brands and products of fine paper to printers, converters, office product retailers and office equipment manufacturers. Merchants distribute to customers up to 3-4 times daily, using their own drivers or contracted transportation services.

MARKET DEFINITION

Introduction

24. The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered, and in which the application of section 47(1) of the Act can be examined.

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

> "... the term 'market' is a reference to 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."

26. Relevant principles relating to market definition are set out in *Telecom v Commerce Commission* ("the AMPS A case") and in the *Business Acquisitions Guidelines*. A brief outline of the principles follows.

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

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

29. Markets are also defined by functional level (the functional dimension). Typically, production, distribution, and sale occur through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be

called the manufacturing market while that between wholesalers and retailers is usually known as the wholesaling market.

Identifying Relevant Markets

30. To identify the markets relevant to this Application, it is necessary to consider the business activities undertaken by the merging firms and to assess whether, post-acquisition, dominance would, or would be likely to, result or be strengthened.

31. Thus the relevant market or markets should be defined so as best to expose the competitive forces at play. As stated in the AMPS A case:

> 'The boundaries {of the market} should be drawn by reference to the conduct at issue, the terms of the relevant section or section, and the policy of the statute. Some judgment is required, bearing in mind that "market" is an instrumental concept designed to clarify the sources and potential effects of market power that may be possessed by an enterprise."

32. In respect of those activities undertaken by one or other of the firms, but not both, it may be that the competitive situation will not change by the acquisition, and in these circumstances the Commission will not usually need to identify the specific market in which the activities may fall.

The View of the Applicant

33. The Applicant has stated that the only activity in which the proposed acquisition will result in aggregation is the distribution of fine papers in New Zealand. It notes that previous Commission Decisions (including Decision 208 – Amcor/NZ Forest Products Ltd of 21 August 1987 and Decision 213 – Fletcher Challenge Ltd/NZ Forest Products Ltd of 5 November 1987) had adopted a market for the manufacture of fine papers including printing, writing and stationery grades which can be either coated or uncoated. The Applicant has followed this approach when delineating the relevant product dimension for the purpose of this Application.

34. The Commission notes that since the earlier Decisions referred to above, the characteristics of the market in New Zealand have changed somewhat, particularly as fine papers are no longer produced domestically. The Commission's approach to market definition in this case follows below.

The Markets Relevant to the Current Application

35. The Commission accepts that the horizontal aggregation from the proposed acquisition arises only in respect of the distribution of fine papers. The PaperlinX subsidiary, Dalton NZ, is a paper merchant in New Zealand, as are the Spicers' subsidiaries, Spicers NZ and Armitron.

36. The Commission accepts that while, on the demand side, different types of fine paper may not be substitutable for each other, their supply characteristics are very similar and paper merchants tend to carry the different types in common. The Commission considers that the competitive implications of the proposed acquisition can be fully assessed within a fine papers product market.

37. The Commission considers that it is appropriate in this case to define the functional market as that for the importation and supply. It recognises that the potential for

retailers and others to import direct, acts as a competitive constraint on the domestic paper merchants of fine paper, and this is discussed further below in the competition analysis.

38. The relevant geographic market is considered to be national.

Conclusion on Market Definition

39. The Commission concludes that the relevant market for considering the likely effects of this proposal is the national market for the importation and supply of fine papers ("the national market for the supply of fine papers").

COMPETITION ANALYSIS

Introduction

The Dominance Test

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

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

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

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

42. The test for dominance has been considered by the High Court. McGechan J stated:[2]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

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

43. Both McGechan J and the Court of Appeal, which approved this test,[3] stated that a lower standard than "a high degree of market control" was unacceptable.[4] The Commission has acknowledged this test:[5]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

44. The Commission's Business Acquisitions Guidelines state:

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

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

46. The Commission applies the dominance test in the following competition analysis.

The National Market for the Supply of Fine Papers

Market Concentration

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

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

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

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

49. These safe harbours recognise that both absolute levels of market share, and the distribution of market shares between the merged firm and its rivals, is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state (at page 17) that:

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

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

51. In this present case, obtaining accurate market share data has proven difficult. The Commission understands that there is no central reporting authority in this industry, other than the Paper Marketing Association ("PMA"). However, not all paper merchants (including a number of large operators) report their figures to the PMA.

52. The Commission has obtained market share data from the PMA, including estimated market shares from a number of major operators. The Commission notes that the "total market" figure advised by these sources is similar to that advised by the Applicant.

53. On the basis of the information available, the market share estimates of the major operators in this market are recorded in Table 1 below.[6]

Table 1
Estimated Market Shares in the National Market for the Supply of Fine Papers

Party	**Annual Tonnes**	**Estimated Market Share (%)**
Spicers	[ ]	[ ]
PaperlinX	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
B J Ball	[ ]	[ ]
CPI Papers	[ ]	[ ]
Others	[ ]	[ ]
TOTAL	**[ ]**	**100%**

[6] These figures only represent the market share of the distribution of fine paper in New Zealand, and do not include direct importation of paper by various parties.

54. On the basis of the above figures, the combined entity's market share is estimated to be [ ]%. The second largest operator has an estimated market share of [ ]%. However, although the Commissions' defined market includes direct purchases from overseas mills, these figures are not readily available and the total imports are not included in Table 1 above. Therefore, the combined entity's market share represents a conservative estimate, as direct purchases of fine papers from overseas mills are not included.

55. From this data, the combined entity's market share falls marginally outside the Commission's "safe harbours" (refer paragraph 48). However, as stated earlier, the fact that a proposed acquisition may lead to a market share falling outside these "safe harbours" does not necessarily mean that it will be likely to result in the acquisition or strengthening of a dominant position in a market. Additional factors must also be considered before a conclusion on dominance is reached. These factors are discussed below.

Existing Competition

56. The Applicant submits that the combined entity would continue to be constrained by the conduct of existing competitors. In particular, the Applicant cites B J Ball as a "vigorous competitor", noting it is a subsidiary of Carter Holt Harvey Ltd. The Applicant also submits that CPI Papers is a strong distributor in the market.

57. The Commission notes that there are a number of current competitors operating in this market. The next largest operator is B J Ball, with an estimated market share of [ ]%. B J Ball, an established operator since the 1930's, is a national distributor with operations in Auckland, Wellington, Christchurch and Dunedin. It has a number of major customers, including [ ] and [ ]. B J Ball sources its fine papers from the USA, South East Asia, and Germany. It distributes its products through its own network of drivers, and contracted driving personnel.

58. CPI Papers, also a major participant in the market, has warehouses in Auckland, Wellington and Christchurch. It operates its own delivery vehicles daily, offering a "just in time" delivery among its services. CPI Papers sources its fine paper supplies primarily from Asia and Europe.

59. The size and market operations of both B J Ball and CPI Papers are such that the Commission considers they are well placed to expand operations, in the event that the combined entity attempts to exert any degree of market power.

60. A number of smaller operators are also well established and provide a degree of competition. For example, B&F has been operating in New Zealand for 80 years, with distribution centres in Auckland, Hamilton, Tauranga, Palmerston North and Christchurch. B&F mainly deal in specialist lines, which are not heavily stocked by the larger operators. These "niche" products are often required in some quantity by printers, converters, and office product retailers. B&F advised Commission staff that in its view the market is "highly competitive" and is characterised by buyers "ringing around" suppliers for the cheapest possible price.

61. Paper merchants and office product retailers are very aware of the presence of alternative suppliers to the merger parties. The same is true of printers and converters. One party [ ] advised that it seeks competitive prices annually from market participants. Another party [ ] advised that it sourced its products directly from a mill until two years ago. It was then approached by [ ], offering to supply

its paper needs. [ ] now purchases its requirements from [ ], who also manages the distribution throughout [ ] national retail stores.

62. Original equipment manufacturers such as Fuji Xerox and Canon also distribute fine papers to their own customer base, and are likely to provide a degree of competition in the market. Fuji Xerox and Canon source paper directly from overseas, or use a mill agent to do so on their behalf. Fuji Xerox stated it [ ]. Canon advised it [ ]. Fuji Xerox advised that [ ].

63. In addition, for large purchasers of fine paper eg Warehouse Stationery, Blue Star Office Products and Webprint (a large magazine printer), the ability to source directly from an overseas mill provides an alternative from obtaining supply from these national paper merchants. Blue Star Office Products advised Commission staff that [ ].

64. In the *Port Nelson* case the test of dominance was discussed and requires that the following question be asked. Would the combined entity, post merger, be able to raise its prices or drop service levels without significant constraint by competitor or consumer reaction? In relation to this Application, the information available to the Commission suggests that this would be unlikely to occur. There are significant alternative suppliers to the combined entity, in addition to the option of direct importation of fine papers.

Potential Competition

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

66. The Applicant submits that there are low barriers to entering the market, and the relative ease and speed with which a new paper distributor can enter is a real constraint.

67. The Commission has found that there are relatively modest entry conditions into this market, dependant upon the size of entry undertaken. For example, industry sources generally advised that entry could be made by sourcing product, leasing warehouse space, and contracting distribution services. Following initial set-up, marketing and ongoing purchases would be the major expenses for a new entrant.

68. Larger operators advised Commission staff that a national distribution service was necessary, as was carrying a sufficient range and volume of fine papers to satisfy immediate customer demand. One large operator [ ] suggested that entry at a large scale may cost up to $30 million. This would involve high volume purchases and storage, strategic locations and national distribution, and extensive sales and marketing programmes.

69. However, the same operator also advised that it was more likely that new entry would be effected on a modest scale, with expansion to follow. An example of this modest entry is Reel Papers (purchased in 1996 by CPI). Reel Papers operated from a

warehouse in Auckland, specialising in reels of self-adhesive paper, as well as paper for continuous business stationery forms.

70. Another small operator [ ] advised that it entered the market on $[ ] capital, and generates turnover of approximately $[ ] per annum. It advised that all that it required for entry was warehouse storage and equipment, computer software and telephone services, and some degree of industry knowledge. It has customers in the South Island, but no physical presence there. To satisfy these orders, it contracts a transport company for deliveries to customers.

71. The Commission concludes that the barriers to entry and expansion are low. That being the case, the threat of potential entry is likely to effect a constraint upon the behaviour of the combined entity.

Conclusion on the National Market for the Supply of Fine Papers

72. The proposal will result in some aggregation of market share for the combined entity, to a level that is likely to fall marginally outside the Commission's "safe harbours". However, the Commission concludes that there is likely to remain effective competition from a number of national fine paper merchants. Further, these paper merchants have the ability to readily expand their operations in this market.

73. In addition, the presence of a wide variety of smaller operators provides a degree of competitive constraint upon the behaviour of the combined entity. Further, the ability of large purchasers of fine paper to source products directly from overseas mills and import into New Zealand provides an additional form of constraint upon the combined entity.

74. The Commission concludes that barriers to entry and expansion are relatively low. Therefore, the threat of potential entry, or expansion by a current competitor, is likely to provide an effective constraint upon the combined entity.

75. The presence of current competitors, and the threat of potential entry, are likely to alleviate any dominance concerns in this market.

OVERALL CONCLUSION

76. The Commission has considered the impact of the proposed acquisition in the national market for the importation and supply of fine papers.

77. Having regard to the factors set out in section 3(9) of the Act, and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

78. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to PaperlinX Limited to acquire the remaining 58% of Spicers Paper Limited.

Dated this 20th day of December 2000

M J Belgrave
Chair