



## COMMERCE COMMISSION

### DECISION NO 459A

Reconsideration pursuant to section 94 of the Commerce Act 1986 of the Commission's findings in Decision No 459 on issues of "association" between National Foods Limited and Fonterra Cooperative Group Limited.

**NATIONAL FOODS LIMITED**

**and**

**NEW ZEALAND DAIRY FOODS LIMITED**

- The Commission:** MJ Belgrave  
PR Rebstock  
PJM Taylor
- Summary of Application:** The acquisition by National Foods Limited through a wholly owned subsidiary of up to 100% of the issued shares in New Zealand Dairy foods Limited
- Determination:** National Foods Limited and Fonterra Cooperative Group Limited are not currently associated for the purposes of section 47 of the Commerce Act 1986
- Date of Determination:** 26 September 2002

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

## CONTENTS

BACKGROUND .....	1
EXECUTIVE SUMMARY .....	1
SCOPE OF RECONSIDERATION.....	1
MATERIAL AND INFORMATION CONSIDERED .....	2
FINDINGS ON ASSOCIATION ISSUE IN DECISION 459 .....	3
UPDATED FACTUAL MATRIX .....	5
CONCLUSION ON ASSOCIATION ISSUE .....	9
APPENDIX.....	10

## BACKGROUND

1. In Decision 459 the Commerce Commission (Commission) declined to give National Foods Limited (National Foods) clearance to acquire up to 100% of the issued shares in New Zealand Dairy Foods Limited (NZDF) from Fonterra Cooperative Group Limited (Fonterra). National Foods issued judicial review proceedings against the Commission and lodged an appeal to the High Court under s 91(1)(a) of the Commerce Act 1986 (Act).
2. On 13 June 2002 (at the instigation of both parties), the High Court directed the Commission pursuant to s 94(1) of the Act to reconsider its conclusion that National Foods and Fonterra were associated persons (association issue)<sup>1</sup>.

## EXECUTIVE SUMMARY

3. The Commission's findings in Decision 459 on the association issue were based on a particular factual matrix. The Commission is satisfied that circumstances have changed materially since it made its original determination and it no longer considers National Foods and Fonterra to be "associated" under section 47(2) of the Act.
4. The Commission has not reconsidered any of its other findings in Decision 459 nor has it considered whether any future acquisition by National Foods of the shares in NZDF would have the effect of substantially lessening competition. The Commission's reconsideration of the association issue does not constitute a clearance under s 66(1) of the Act.
5. To the extent that it may limit the degree of rivalry between them, Fonterra's shareholding in National Foods would still be a relevant factor when determining whether an acquisition would have or would be likely to have the effect of substantially lessening competition in a market.

## SCOPE OF RECONSIDERATION

6. In directing the Commission to reconsider the association issue, the High Court concluded that the reconsideration was justified in the light of subsequent developments since the original determination and the existence of additional information not previously available to the Commission. In particular, the Court referred to the following changes in circumstances:
  - (a) The sale of NZDF to a third party;
  - (b) The possibility that National Foods may apply for clearance to purchase up to 100% of the shares in NZDF from the new owner;
  - (c) National Foods' affidavit evidence in the judicial review proceedings, which contains a large amount of new material relating to the association issue.

---

<sup>1</sup> *National Foods Limited v Commerce Commission* (unreported High Court of New Zealand, Auckland Registry, Commercial List, 13 June 2002, Judgment of Rodney Hansen J and Kerrin M Vautier)

7. The Court also made the following directions:
  - (a) The Commission should, in carrying out its reconsideration of the association points, consider the material contained in the seven affidavits filed in the High Court and any other evidence, submissions or representations presented to it by National Foods;
  - (b) Such reconsideration arises from a desire of National Foods to have the analysis, conclusions and/or observations on the association points contained in Decision 459 reconsidered;
  - (c) National Foods will have the usual opportunity fully to respond to any issues or concerns of the Commission contrary to the interests of National Foods in relation to the association points and to respond to any expert opinions or material obtained by or to be considered by the Commission.
8. When carrying out a reconsideration under s 94, the Commission is entitled to undertake further investigations and consider additional information to that which was before it at the time of the original determination<sup>2</sup>. However, in doing so it must have regard to the Court's reasons for directing the reconsideration and any Court directions<sup>3</sup>.
9. The Commission's analysis of the additional material provided to it by National Foods necessitated further investigations. The Commission considers that such investigations were consistent with both the reasoning behind the Court's decision to direct a reconsideration of the association issue and the specific Court directions provided.
10. The Commission has not reconsidered any of its findings in Decision 459 other than those relating to the association issue nor has it considered whether any future acquisition by National Foods of the shares in NZDF would have the effect of substantially lessening competition. The Commission's reconsideration of the association issue does not constitute a clearance under s 66(1) of the Act.

#### **MATERIAL AND INFORMATION CONSIDERED**

11. Since the Court's direction that the Commission reconsider the association issue, the Commission has carried out investigations and had regard to information additional to that which was before it at the time of the original determination. The additional information to which the Commission has had regard in making its determination is as follows:
  - (a) Submissions dated 28 June 2002 received from Simpson Grierson on behalf of National Foods;
  - (b) Material contained in the following affidavits<sup>4</sup>:
    - (i) Bruce David Grundy sworn 17 May 2002;

---

<sup>2</sup> *Goodman Fielder Ltd v Commerce Commission* (1987) 2 NZLR 10, 17

<sup>3</sup> Section 94(3) of the Act

<sup>4</sup> Refer to Appendix A for background information and qualifications.

- (ii) William Barrett Capp sworn 14 May 2002;
  - (iii) Alexander Sundakov affirmed 20 May 2002;
  - (iv) Maxwell Gilbert Ould sworn 20 May 2002;
  - (v) Warren Arthur Larsen sworn 10 May 2002;
  - (vi) Ian Andrew Renard sworn 14 May 2002; and
  - (vii) Clive Anthony Hooke sworn 17 May 2002.
- (c) Expert advice and opinion from Basil Logan, Chairman of Opus International Consultants Limited;<sup>4</sup>
  - (d) [ ];
  - (e) Statements and representations from Lloyd Kavanagh, senior executive of Fonterra;
  - (f) Statements and representations from Carine Stein, senior executive of Danone Asia.
12. The Commission's reconsideration of the association issue is based on an analysis of the facts as at the present date. The Commission has also relied upon representations set out in the affidavits provided by National Foods and upon statements and representations made by Fonterra and Danone Asia<sup>5</sup>. If circumstances were to change materially then the Commission's view on the association issue may also differ.

#### **FINDINGS ON ASSOCIATION ISSUE IN DECISION 459**

13. Decision 459 involved a determination by the Commission of National Foods' application for a clearance under s 66 of the Act to acquire 100% of Fonterra's shares in NZDF. At that time, s 9 of the Dairy Industry Restructuring Act 2001 (DIR Act) applied to the sale as it prohibited Fonterra from selling its shares in NZDF to a person with whom it was "associated". Section 5(2) of the DIR Act set out four alternative definitions of "association"; the only one that was relevant to a sale of the shares to National Foods was set out in s 5(2)(d):

*A person is an associated person of another person if either of them is able, directly or indirectly, to exert a substantial degree of influence over the activities of the other.*

14. In Decision 459, the Commission considered that the tests for association under s 5(2)(d) of the DIR Act and s 47 of the Commerce Act involved a consideration of the same factors. This approach was originally the subject of appeal by National Foods. However, since Decision 459 Fonterra has disposed of its shares in NZDF to Rank Group Limited ("Rank") and the association issue under the DIR Act is no

---

<sup>5</sup> Danone Asia is a large multinational company with interests in the dairy industry. They currently hold a 10% share in National Foods.

longer relevant. National Foods has confirmed that the Commission's reconsideration should therefore be limited only to the association issue under the Commerce Act<sup>6</sup>.

15. Section 47 of the Act reads:

*(1) A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.*

*(2) For the purposes of this section, a reference to a person includes 2 or more persons that are interconnected or associated.*

*(3) For the purposes of this section, a person is associated with another person if that person is able, whether directly or indirectly, to exert a substantial degree of influence over the activities of the other.*

*(4) A person is not able to exert a substantial degree of influence over the activities of another person for the purposes of subsection (3) by reason only of the fact that—*

*(a) those persons are in competition in the same market; or*

*(b) 1 of them supplies goods or services to the other.*

16. The relevance of the association test under the Commerce Act is that (for the purposes of s 47 of the Act) whenever there is an acquisition of business assets or shares, the person acquiring them includes not only the actual purchaser but also any other persons with whom the purchaser is associated (or interconnected). Therefore, the implication of finding National Foods and Fonterra to be associated is that an acquisition by National Foods would be deemed also to be an acquisition by Fonterra.

17. The nature of the relationship between National Foods and Fonterra may also be a consideration in any competition analysis under the Act. In particular, to the extent that it may limit the degree of rivalry between them, Fonterra's shareholding in National Foods would still be a relevant factor when determining whether an acquisition would have or would be likely to have the effect of substantially lessening competition in a market<sup>7</sup>.

18. In Decision 459 the Commission's conclusions on the competition analysis of National Foods' application for a clearance meant that it was not necessary to determine the association issue. However, it concluded that if it had been required to make such a determination, it would have found that National Foods and Fonterra **were** associated as Fonterra was able to exercise a substantial degree of influence over National Foods<sup>8</sup>. In forming this view, the Commission had regard to the following factors:

- (a) The likelihood of rationalisation within the Australian dairy industry;
- (b) Indications that National Foods and Fonterra want to participate in such rationalisation;

<sup>6</sup> Simpson Grierson submissions, paras 12-13

<sup>7</sup> Para 4.5 of Practice Note 4: *The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in Section 47 – A Test of Substantially Lessening Competition*

<sup>8</sup> Decision 459, paras 58-59

- (c) Fonterra's strategic power via its current shareholding in National Foods;
  - (d) Fonterra's shareholding in National Foods being twice the size of any other single shareholding;
  - (e) Fonterra's potential ability, as a result of its size and position in world dairy markets, to influence other shareholders in National Foods;
  - (f) Fonterra's potential ability to gain the support of other shareholders and thereby gain more influence with National Foods by, for example Board representation;
  - (g) Fonterra's indication that it is reviewing its position in the Australian dairy industry.
19. The Commission's starting point is to review the new evidence and information and determine whether the factual matrix has changed materially since it determined Decision 459. And, if so, whether the changes affect the Commission's previous views on the association issue.

## **UPDATED FACTUAL MATRIX**

### **The likelihood of rationalisation within the Australian dairy industry**

20. Rationalisation within the Australian dairy industry is still likely. The relevance of this factor is that the industry is likely to be in an unstable state. This instability would potentially make it more likely that Fonterra's stake would have greater strategic importance. This in turn is a relevant factor in analysing Fonterra's motivations and expectations in respect of its shareholding in National Foods.
21. [

]

### **Indications that National Foods and Fonterra want to participate in such rationalisation**

22. National Foods and Fonterra both have a significant presence in the Australian dairy industry. The Commission has received no submission suggesting that both parties would not wish to participate in any rationalisation of this industry.
23. The Commission's investigations indicate that if Fonterra were to use National Foods to participate in this rationalisation it is more likely to do so by increasing its shareholding in National Foods. Such a transaction would be required to comply with competition laws in both New Zealand and Australia.

### **Fonterra's strategic power via its current shareholding in National Foods**

24. Since Decision 459, Fonterra's shareholding in National Foods has decreased from 17.9% to 17.7%. This reduction was not due to any deliberate divestment by

Fonterra, but because Fonterra did not elect to participate in National Foods' dividend reinvestment plan.

25. Fonterra's shareholding is sufficient to prevent a 100% takeover of National Foods. Under Australian Corporations law a person may only compulsorily acquire all minority shares in a company if that person and its associates have a relevant interest in 90% of the issued securities<sup>9</sup>.
26. As a 100% takeover is normally required to give an acquirer the full benefit of a corporate rationalisation, the ability to block a takeover could potentially enable Fonterra to dictate the future role of National Foods in the Australian dairy industry. However, it was Basil Logan's opinion that this negative power, by itself, would not enable Fonterra to exert a substantial influence over National Foods.
27. The Commission notes that, Danone Asia (with a 10% shareholding) is also now in the position of preventing complete control.
28. Further, in the absence of approval of a 100% takeover from Dairy Farmers (9.2%) or Maple Browne Abbott (9.0%) it would be almost impossible for Fonterra, Danone Asia or any one else to achieve a 100% takeover.
29. The Commission considers that the existence of two other shareholders with a presence in the dairy industry means that Fonterra's influence in this regard is now less than it was.
30. Fonterra's current level of shareholding could also enable it to exert influence over motions requiring a special resolution. Under Australian corporations legislation, a special resolution must be passed by at least 75 % of the eligible votes cast by shareholders in person or by proxy (if allowed)<sup>10</sup>.
31. As at 7 June 2002, the top 15 shareholdings in National Foods accounted for 62.1% of the issued share capital and are held largely by institutional investors. Unless a large percentage of minority shareholders exercised their right to vote, Fonterra's shareholding could be enough to block a special resolution.
32. However under Australian corporations law, special resolutions are generally reserved for major questions affecting either the company as a whole or shareholder rights (for example liquidation, changes to the company constitution, and selective reduction of share capital)<sup>11</sup>. Unlike the situation in New Zealand, there is no general requirement for special resolutions in respect of major transactions or company amalgamations<sup>12</sup>. So, it is doubtful that Fonterra's ability to block special resolutions would result in the frustration of National Foods' strategic objectives.
33. The Commission has consulted Basil Logan for his opinion on factual issues raised in the reconsideration of the association issue. Mr Logan doubted that the ability to block special resolutions by itself would enable Fonterra to influence National Food's strategic objectives.

---

<sup>9</sup> Sections 661A and 664A Corporations Act 2001(Aust Cth)

<sup>10</sup> Section 9 Corporations Act 2001 (Aust Cth)

<sup>11</sup> Refer Corporations Act 2001 ss.136, 163, 254W, 256C, 257B, 257D, 260B, 506, 507, 601GC.

<sup>12</sup> Cf s106 Companies Act 1993 (NZ)



34. Under Australian corporations law, to extend its shareholding beyond 19.9% Fonterra would either have to mount a full takeover bid or increase its shareholding at no more than 3% per 6 months<sup>13</sup>. Any further acquisition of shares would also need to comply with competition laws in Australia and New Zealand.

**Fonterra's shareholding in National Foods being twice the size of any other single shareholding**

35. Since Decision 459, there have been important changes in the shareholding of National Foods. Fonterra remains the largest shareholder of National Foods. However, the distribution of shareholdings other than Fonterra is such that other major shareholders could together outvote Fonterra.
36. Fonterra's present shareholding is no longer twice the size of any other single shareholding. Other major shareholders now include Danone Asia (10%), Dairy Farmers (9.2%) and Maple Brown Abbot (9.0%). The Commission considers it particularly significant that other industry participants (Danone Asia a large multinational company with interest in the dairy industry and Dairy Farmers) now hold substantial shareholdings.

**Fonterra's potential ability, as a result of its size and position in world dairy markets, to influence other shareholders in National Foods**

37. The Commission was previously concerned that Fonterra's size and position in world dairy markets would potentially influence other shareholders. This was particularly so given that at the time of Decision 459, Fonterra was the only industry participant shareholder with a substantial shareholding. However, since then Danone Asia has acquired 10% of the shares in National Foods and Dairy Farmers has increased its shareholding to nearly 10%. Both of these companies have interest and experience in the dairy industry. The effect of these changes is that other purely investment shareholders are less likely to be influenced by Fonterra.

**Fonterra's potential ability to gain the support of other shareholders and thereby gain more influence with National Foods by, for example Board representation**

38. Basil Logan considered board representation to be the most important factor in assessing Fonterra's ability to influence National Foods' behaviour. [
- ]
39. The election of company office holders requires a majority consensus of shareholders. In the absence of a significantly low number of voter turnout (which is unlikely, given that the top 15 shareholders currently hold more than 60% of all shares), Fonterra, acting unilaterally and without the support of other shareholders, would be unlikely to succeed in having a nominee appointed to the Board at a general meeting.

---

<sup>13</sup> Exception 9 to the prohibition in the Australian Corporations Act 2001 states "An acquisition by a person if: (a) throughout the 6 months before the acquisition that person, or any other person, has had voting power in the company of at least 19%; and (b) as a result of the acquisition, none of the persons referred to in paragraph (a) would have voting power in the company more than 3 percentage points higher than they had 6 months before the acquisition."

40. The Commission has also had regard to the representations made by the Chairman of National Foods that there is no present or future intention to invite a nominee of Fonterra onto the National Foods Board<sup>14</sup>. [

]

41. The Commission notes that it would be difficult for Fonterra to increase its shareholding to a point where it would be more likely to gain board representation. Any such increase would need to comply with competition laws in Australia and New Zealand.

42. The Commission has had regard to Ian Renard's affidavit. In his opinion:

*Virtually any agreement or understanding entered into between Fonterra and another shareholder relevant to their respective shareholdings would have to be disclosed under the substantial shareholding requirements of the Corporations Act (sections 671B). If the other party had a shareholding of more than 2.3% - resulting in the combined shareholdings of Fonterra and the other party exceeding 20% - such an understanding would be prohibited by the Australian takeovers legislation (section 606) unless exempted by the Australian Securities and Investments Commission (an unlikely outcome) or approved by resolution in general meeting of the shareholders in National Foods (at which meeting Fonterra and the other party would be precluded from voting).<sup>15</sup>*

The Commission accepts that Fonterra's ability to act in concert with other shareholders is severely restricted under Australian corporations law.

43. Basil Logan was also of the view that unless there was a "community of interest" (such as poor performance of the company), then Fonterra is unlikely to gain the general support of other shareholders. The Commission is unaware of any existing factors that would give rise to such a community of interest.

#### **Fonterra's indication that it is reviewing its position in the Australian dairy industry**

44. [

]

45. [

]

---

<sup>14</sup> Capp affidavit, para 9

<sup>15</sup> Renard affidavit, para 34(c)

46. Previously the Commission was concerned that non-industry shareholders would be likely to support a Fonterra nominee on the National Foods Board. This is less likely now in the light of substantial shareholdings held by other industry participants. The Commission is satisfied that now if Fonterra was to use National Foods as a vehicle for improving its position in the Australian Dairy Industry, it would need to take active steps to change its current position (for example, increase its shareholding in National Foods or enter into an arrangement with other shareholders). [ ] Any such action would need to comply with relevant corporations and competition law in Australia and New Zealand.

#### **CONCLUSION ON ASSOCIATION ISSUE**

47. The Commission is satisfied that changes to the factual matrix since Decision 459 have reduced the possibility that Fonterra could exert a substantial influence over National Foods. The Commission concludes that it does not consider National Foods to be associated under s.47 of the Act.
48. Due to its finding in paragraph 47 (above), the Commission has not found it necessary to review further its findings on the association issue in Decision 459.

Dated this 26<sup>th</sup> day of September 2002

---

MJ Belgrave  
Chair

## APPENDIX

**William Barrett Capp:** Mr Capp is the Chairman of the Board of National Foods Limited and has held this position since 1991.

**Bruce David Grundy:** Mr Grundy has a PhD in Finance from the University of Chicago and is a professor of Corporate Governance at the Melbourne Business School. He has considerable experience consulting for a number of commercial organizations and law firms in Australia, including ABN Amro, Blake Dawson Waldron, Clayton Utz, Freehills, TransGrid and the Victorian Department of Treasury and Finance.

**Clive Anthony Hooke:** Mr Hooke is the Chief Financial Officer of National Foods Limited and has held this position since 1997. From 31 March 1996 to 30 June 2000, Mr Hooke was the co-owner of International Fine Foods Limited, a business that was purchased by National Foods on 1 July 2000. He has considerable experience in the New Zealand domestic and international markets for dairy products, including those for yoghurt and dairy desserts, cultured dairy products and consumer dairy products.

**Warren Arthur Larsen:** From 1992 to June 2001 Mr Larsen was the Chief Executive Officer of the New Zealand Dairy Board. He is also the Director of a number of listed companies including Fletcher Challenge Forest Limited, Richmond Limited, Vending Technologies Limited, Owens Group Limited and Air New Zealand Limited.

**Basil Logan:** Mr Logan has had considerable experience on the Boards of New Zealand companies, both as Chairman and Director; is a past President of the Institute of Directors in New Zealand and is, currently, Chairman of Opus International Consultants Limited.

**Maxwell Gilbert Ould:** Mr Ould is the Managing Director and Chief Executive Officer of National Foods Limited and has held this position since September 1996.

**Ian Andrew Renard:** Mr Renard is a solicitor practising commercial law in Australia. He is presently a consultant to the law firm Allens Arthur Robinson and a member of several boards and board committees in Australia. Mr Renard is also the co-author of the loose-leaf Butterworths publication *Takeovers and Reconstructions in Australia*.

**Alexander Sundakov:** Mr Sundakov has been the Director of the New Zealand Institute of Economic Research since July 1997. Prior to this, he worked for five years at the International Monetary Fund with extensive experience in policy analysis and negotiations in markets and finance issues. He has given evidence in a number of proceedings under the Commerce Act, acting for a mixture of both plaintiffs and defendants.