ISSN NO. 0114 - 2720

COMMERCE COMMISSION

DECISION NO. 301

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

SOUTH ISLAND DAIRY FARMERS LIMITED

and

GREY DISTRICT CO-OPERATIVE MILK PRODUCERS ASSOCIATION LIMITED and SCENICLAND MILK & CREAM LIMITED

The Commission: Alan Bollard (Chairman)
Peter Allport
Kate Brown

Summary of Proposal: That South Island Dairy Farmers Ltd acquire the fresh milk and cream processing business in Greymouth of Grey District Co-operative Milk Producers Association Limited and Scenicland Milk & Cream Limited.

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

Date of Determination: 3 July 1997.

AUT/BA - S6/3-4
M2344 and M2345

MEMORANDUM

To:	Alan Bollard Peter Allport Kate Brown
From:	Jeff Hamilton Jane Chilcott John Preston
Date:	3 July 1997
Subject	**Business Acquisitions: South Island Dairy Farmers Ltd/Grey District Co-operative Milk Producers Association Ltd and Scenicland Milk & Cream Ltd/ Westport United Dairies Ltd**

Working Day 6: 3 July 1997 **Working Day 10: 9 July 1997**

THE PROPOSALS

1 On 25 June 1997, the Commission registered two notices from South Island Dairy Farmers Ltd ("SIDF"), seeking clearance to acquire the fresh milk and cream (i.e. town milk) processing businesses of Westport United Dairies Ltd ("Westport United") at Westport, and Scenicland Milk & Cream Ltd ("Scenicland") at Greymouth. Scenicland is 100% owned by Grey District Co-operative Milk Producers Association Ltd ("Grey District Co-op").

2 As a result of the proposed acquisitions, Scenicland and Westport United will cease their involvement in the processing and sale of town milk. The current shareholders of the two town milk processors will supply their total output to

another independent company, the Westland Co-operative Dairy Company Ltd ("Westland Co-op"). That company is involved in the manufacture of dairy products for export, and has no activities in town milk supply. SIDF will supply the West Coast and Buller regions with town milk from its processing facility in Christchurch.

THE PROCEDURES

3 Section 66(3) of the Commerce Act 1986 ("the Act") requires the Commission either to clear, or to decline to clear a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. The due date for the decisions on the acquisitions is 9 July 1997.

4 This report concludes that staff are satisfied that implementation of the proposals would not result, or would not be likely to result, in SIDF acquiring or strengthening a dominant position in a market, and recommends that, in terms of s 66(3)(a) of the Act, the Commission gives clearances to each of the two acquisitions.

THE PARTIES

South Island Dairy Farmers Ltd ("SIDF")

5 SIDF is a Christchurch-based dairy co-operative company involved in the purchase of raw milk from its 200 supplying shareholders, and the processing and distribution of that milk. The company is also involved in the manufacture and sale of yoghurts, cream cheeses and other cultured foods, flavoured milk products, fruit juices, and the conversion of milk into milk powder for export. SIDF, which has processing facilities in Christchurch and Dunedin, and which owns a 50% interest in a plant at Balclutha, sells packaged milk in most parts of the South Island under the "Meadow Fresh" trade name. SIDF also processes and packages milk for sale to certain supermarkets under housebrand names.

6 SIDF has annual white milk sales of approximately 52.6 million litres.

Westport United Dairies Ltd

7 Westport United is involved in the purchase of raw milk from its three supplying

shareholders, and the processing and sale of milk and cream from a plant at Westport. The company supplies fresh milk in the Buller region, including Westport.

8 Since deregulation of the town milk industry in 1993, Westport United has sold milk in the Buller area under the "Meadow Fresh" trade name, pursuant to a franchise agreement with SIDF. The company is also contracted by SIDF to process and package milk for sale to certain supermarket chains under housebrand names.

9 Westport United has annual white milk sales of approximately 1.4 million litres.

Grey District Co-operative Milk Producers Association Ltd/Scenicland Milk & Cream Ltd

10 The Greymouth processor, Scenicland, is 100% owned by Grey District Co-op. It is involved in the purchase of raw milk from its six supplying shareholders, and the processing and sale of milk and cream. Scenicland supplies milk in the area extending from Punakaiki to Haast, including Greymouth and Hokitika. It markets milk under the "Meadow Fresh" trade name, pursuant to a franchise agreement with SIDF, and is involved in processing and packaging milk for sale to certain supermarket chains under contract to SIDF.

11 Scenicland has annual white milk sales of approximately 2.7 million litres.

BACKGROUND TO THE NEW ZEALAND DAIRY INDUSTRY

12 The Commission has previously assessed, on a number of occasions, business acquisition proposals involving the dairy industry, principally in the North Island. The most recent reports include *Kiwi Co-operative Dairies Ltd/Tui Milk Products Ltd*, M2305, 15 August 1996, *New Zealand Co-operative Dairy Company Ltd/East Tamaki Co-operative Dairy Company Ltd,* M2311, 2 September 1996, *New Zealand Co-operative Dairy Company Ltd/Bay Milk Products Ltd,* M2316, 27 September 1996, and *Mainland Products Ltd/Kiwi Co-operative Dairies Ltd*, M2317, 15 October 1996. The information relating to the structure of the dairy industry, which is outlined in some of those reports, will not be reproduced in this report.

13 Like the North Island, the South Island dairy industry is characterised by a co-operative structure. That is, all companies are owned by their supplying shareholders. However, whereas the North Island dairy industry has been subject to significant rationalisation over recent years, the South Island industry has not experienced the same level of activity.

14 Since deregulation of town milk industry, all South Island processors have expanded their range of products, and some processors have extended the geographic coverage of their supply areas. In particular, SIDF has extended its coverage to include most areas of the South Island. Likewise, Southern Fresh Milk Co Ltd ("Southern Fresh"), which operates a processing facility at Invercargill, has extended its geographic coverage to include many parts of the South Island. More recently, Kiwi Co-operative Dairies Ltd ("Kiwi"), the second largest dairy company in New Zealand, has acquired the business of the town milk processor at Timaru (see para 27 for further details).

15 It is against the market background outlined above that the current proposals are taking place. Many in the industry expect that there will be further changes to the existing structure of the town milk industry in the South Island over the next few years.

THE MARKETS

Background

16 The Commission has examined the issue of market definition in relation to a number of business acquisition proposals involving the dairy industry in recent years. In the staff report on the *Kiwi/Tui* proposal, two markets which were examined related to the acquisition/supply of unprocessed milk in the greater part of the North Island, and the processing and wholesale delivery of town milk in the greater part of the North Island. Subsequently, those markets have been examined in two further business acquisition proposals: *New Zealand Co-operative Dairy/East Tamaki* and *New Zealand Dairy Co-operative/Bay Milk*.

17 In the current proposals, the relevant product/function markets are considered to be the supply/acquisition of unprocessed milk, and the processing and wholesale supply of town milk. The proposals will, however, result in no material change to the market circumstances for unprocessed milk. This is because following

implementation of the proposals, the suppliers to the Greymouth and Westport processors will supply their total raw milk output to Westland Co-op, which operates a dairy manufacturing plant at Hokitika. As a consequence, there will be no aggregation of business activity in relation to the supply/acquisition of unprocessed milk, and we do not propose to deal with this market in any further detail in this report.

The Market for the Processing and Wholesale Supply of Town Milk

18 As noted above, this market has been examined on several occasions in the past by the Commission, mainly in relation to the North Island. The main issue examined has been the geographic scope of the town milk market. The conclusion reached in recent reports involving North Island dairy acquisitions has been that the geographic market includes at least the greater part of the North Island.

19 Our enquiries into the current proposals indicate that a similar situation applies in the South Island. In fact, it has been argued by several industry participants that the geographic market incorporates the entire South Island. While the cost of transporting milk is not insignificant, it does not appear to represent a major obstacle to milk being delivered over large distances on an economic basis. For example, SIDF is transporting packaged milk daily from its Christchurch processing plant to Nelson, and following the implementation of the current proposals, the company is planning to transport milk daily to the West Coast, also from its Christchurch plant.

20 Southern Fresh is currently supplying packaged milk from Invercargill to Canterbury, and to the Nelson and Marlborough regions on a daily basis. [

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21 In addition, staff consider that the regions supplied by the various town milk processors in the South Island overlap, and are inter-related to such an extent, that it is possible to delineate a wider South Island geographic market.

Conclusion on Market Definition

22 Having regard to the above factors, we consider that it is appropriate to define the geographic market as incorporating the entire South Island. In this report, we therefore propose to define the relevant market as that for the processing and wholesale supply of town milk in the South Island.

ASSESSMENT OF DOMINANCE IN THE MARKET FOR THE PROCESSING AND WHOLESALE SUPPLY OF TOWN MILK

Current Competition

23 At present, there are seven co-operative companies engaged in the processing and supply of milk for local consumption in the South Island.

24 Of those companies, SIDF is the largest single town milk processor. It processes town milk at Christchurch and Dunedin, and markets its output under the "Meadow Fresh" brand. The company also owns 50% of the shares in the town milk processing company at Balclutha. SIDF supplies packaged milk to all parts of the South Island, with the exception of the West Coast, Buller, Marlborough, Mid Canterbury and South Canterbury areas. In the Marlborough region, Marlborough Milk Company Ltd ("Marlborough Milk") processes and supplies " Meadow Fresh" milk from a facility at Blenheim in terms of a franchise agreement with SIDF.

25 As noted in the section describing the activities of the parties to the proposals, Westport United processes town milk at a plant located at Westport, and distributes the output in the Buller region, while Scenicland has a plant at Greymouth and supplies the West Coast region. Both Westport United and Scenicland market their milk under the "Meadow Fresh" label in terms of franchise agreements with SIDF. The two companies have traditionally accounted for virtually all milk supplied to the West Coast and Buller regions.

26 There are two companies in the South Island which process and market milk under the "Anchor" brand in accordance with franchise agreements with the New Zealand Co-operative Dairy Company Ltd ("NZCDC"), the owner of the brand. Southern Fresh is a town milk processor based in Invercargill, supplying milk predominantly in the lower half of the South Island. The company also supplies

milk as far north as Nelson and Blenheim. The other "Anchor" franchisee is Nelson Milk Company Ltd ("Nelson Milk"), a town milk processing company which supplies fresh milk in the Nelson region.

27 Kiwi, the second largest dairy co-operative in New Zealand, is involved in the collection, manufacture and distribution of milk and dairy products. Last year, Kiwi purchased the town milk processing company in Timaru (Timaru Milk Ltd). Subsequently, Mainland Products Ltd ("Mainland") acquired 100% of the shares in Timaru Milk, together with Kiwi's interests in town milk supply and various consumer dairy products in the North Island, and Kiwi acquired a 66% interest in Mainland. Currently, Mainland only supplies fresh milk in the South and Mid Canterbury regions.

Market Shares

28 On the basis of liquid milk production figures supplied by the various suppliers of town milk, market shares for the South Island are estimated as follow:

	% (Approx)
SIDF	61
Westport United	3
Scenicland	2
	66
Southern Fresh	14
Nelson Milk	8
Kiwi/Mainland	7
Marlborough	5
	100

Entry/Expansion Conditions

29 The principal factor affecting entry and expansion into the town milk market is considered to be access to a regular supply of raw milk on a year-round basis. Other relevant factors include:

- the cost of installing processing and packaging equipment and distribution facilities; and

- access to retail outlets, including supermarkets.

30 In the short term, at least, we consider that expansion by an existing town milk processor in the South Island represents a more practical option than new entry. Both Southern Fresh and Nelson Milk appear capable of increasing the volume of milk they already supply in the South Island with relative ease, and in a timely manner. We have been advised that currently Kiwi is limited in terms of access to a sufficient volume of raw milk on a year-round basis, and therefore is unable to expand production dramatically in the short term.

31 Additionally, we have been told by [

] It is noted also that SIDF has announced that it intends to commence a home delivery service in the Nelson area in about a fortnight's time, using a network of vendors who were previously contracted to Nelson Milk. While these developments are likely to lead to a reduction in Nelson Milk's market share, we consider that there is scope for the company to expand into other regions (e.g. the West Coast and/or Buller).

32 As noted in previous reports relating to the business acquisitions involving dairy companies, it is possible that a new entrant might enter the market to process and deliver town milk. One such possibility, and one which is common practice overseas, is for some supermarket chains to have a shareholding interest in a plant, or own their own plant. Some supermarket chains told the Commission during the examination of the *Kiwi/Tui* proposal that, although they do not have any current intentions to investigate such a proposal, they could do so if the circumstances changed.

33 Alternatively, entry might be achieved by one of the existing manufacturing dairy co-operatives diversifying into town milk processing. For example, one dairy manufacturing co-operative company (Westland Co-op) told us that it would be feasible for the company to enter the town milk market, although it had no current plans to do so. Additionally, it contends that there would be few barriers to it entering the market.

Role of Supermarkets

34 Supermarkets have a major role in the distribution of town milk. We have been told by industry participants that supermarket sales account for about one-third of total milk sales in the South Island, although this figure is subject to regional variations.

35 While proprietary brands of liquid milk account for most milk sold in supermarkets, there has been a trend for increased sale of milk in supermarkets' own housebrands. All the major chains of supermarkets invite tenders from town milk processors to supply all, or part of their housebrand milk requirements. The tendering process is a very competitive one.

36 In terms of the current proposals, there is no significant change to the situation in regard to supermarket housebrand milk. SIDF will continue to supply the New World, Countdown and Supervalue supermarket chains with housebrand milk, while Southern Fresh will handle the Woolworths and Pak'N Save housebrand labels. In any event, those supermarket operators spoken to consider that the proposed acquisitions will have no significant effect on the range of supply options available for housebrand milk.

37 Apart from sales through supermarkets, there is a significant volume of milk sold through the route trade. In this category, it is noted that the sales volume of milk sold through service stations has increased, largely at the expense of dairies and home delivery services.

Assessment of Dominance

38 Implementation of the proposals would result in some horizontal aggregation of market share, with the combined entity increasing its market share in the town milk market in the South Island from about 61% to approximately 66%.

39 The largest of the remaining competitors (Southern Fresh) would account for no more than a 15% market share at the maximum, and the other market participants would all have less than a 10% market share. While we do not consider this to be so, a preliminary assessment might suggest that competitors are unlikely to provide a sufficient constraint on the combined entity.

40 Two of the competing processors (Southern Fresh and Nelson Milk) have a common interest in that they are both franchisees for the "Anchor" brand. The "Anchor" brand is a long established brand which is owned by NZCDC, the largest milk processing company in the country. Both "Anchor" franchisees in the South Island are well established companies which have increased the "Anchor" share in the South Island in recent years, and they appear to be capable of further expanding their competitive presence, if the market circumstances warrant it. In particular, Southern Fresh has grown from largely a supplier of milk to the Southland region to one that now has a presence throughout many parts of the South Island.

41 Kiwi, which ultimately controls the Timaru-based town milk processor, is currently supplying milk to only the South and Mid Canterbury regions. [

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42 We consider that the market for the processing and wholesale supply of town milk in the South Island is highly competitive, and that while not all processors are capable of expanding their activities in the short term, they might be able to do so in the longer term, given the appropriate incentives.

43 Apart from expansion by existing processors, we consider that entry conditions are not so onerous as to rule out *de novo* entry. One possibility is for a dairy co-operative company in the South Island with no existing town milk interests to diversify into processing and supplying town milk, while another possibility might be entry by a supermarket chain, either directly, or through encouraging a new player into the market.

44 In addition, staff consider that a major constraining influence is provided by the major supermarket chains which are significant purchasers of packaged milk, and which have a major role as purchasers of proprietary brands of milk, and as resellers of housebrand milk.

45 Staff have reached the view that the proposals will lead to no significant change in the competitive environment for the processing and wholesale supply of town milk in the South Island. This is because Westport United and Scenicland have traditionally accounted for virtually 100% of town milk sales in the West Coast and Buller regions. Even since the deregulation of the town milk industry in 1993, the

two processors have faced only very limited direct competition from milk processors outside the West Coast and Buller regions. Additionally, under the deregulated industry structure, the two processors have never supplied milk outside their immediate areas. Rather, they have been limited to supplying milk to their immediate regions in terms of franchise agreements with the acquiring party, SIDF. In our view, neither Westport United nor Scenicland are of a sufficient size to provide any effective constraint on competition (actual or potential) in the market for the processing and wholesale supply of town milk in the South Island.

46 Taking the above factors into account, and the close relationship between the two town milk processors and SIDF, the proposed acquisitions would appear to have only a limited impact on existing competition in the South Island town milk market. Further, we consider that the proposed acquisitions would not result in entry barriers being raised to any significant extent. As noted above, staff consider that that there do not appear to be any major obstacles facing other South Island processing companies from expanding their existing geographic coverage, including the West Coast and Buller areas, or for new entrants to commence operations, if the combined entity were to raise its prices, or to lower the quality of its services.

CONCLUSION

47 We conclude that the proposed acquisitions, if implemented, would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the processing and wholesale supply of town milk in the South Island.

RECOMMENDATION

48 We recommend that you give clearances to each of the two proposals under s66(3)(a) of the Act.

______________	______________
Investigator	Investigator
______________	______________
Chief Investigator	Manager

DETERMINATION TO GRANT NOTICE OF CLEARANCE:
SOUTH ISLAND DAIRY FARMERS LTD/GREY DISTRICT CO-OPERATIVE MILK PRODUCERS ASSOCIATION LTD AND SCENICLAND MILK & CREAM LIMITED

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3)(a) of the Commerce Act 1996 (the Act), we hereby give clearance for South Island Dairy Farmers Ltd, or any interconnected body corporate thereof, to acquire the fresh milk and cream processing business operated by Grey District Co-operative Milk Producers Association Limited and Scenicland Milk & Cream Ltd

In terms of s 66(5) of the Act, this clearance shall expire twelve months after the date of this notice. Brief particulars of this clearance will appear in the Commission's public register.

This clearance is given only to the proposed acquisition described in the notice seeking clearance dated 24 June 1997.

Dated at Wellington this day of 1997

A E Bollard	P C Allport	K M Brown
Chairman	Deputy Chairman	Member

DETERMINATION TO GRANT NOTICE OF CLEARANCE:
SOUTH ISLAND DAIRY FARMERS LTD/WESTPORT UNITED DAIRIES LTD

We agree/disagree with the recommendation.

We are satisfied/not satisfied that implementation of the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3)(a) of the Commerce Act 1996 (the Act), we hereby give clearance for South Island Dairy Farmers Ltd, or any interconnected body corporate thereof, to acquire the fresh milk and cream processing business operated by Westport United Dairies Limited.

In terms of s 66(5) of the Act, this clearance shall expire twelve months after the date of this notice. Brief particulars of this clearance will appear in the Commission's public register.

This clearance is given only to the proposed acquisition described in the notice seeking clearance dated 24 June 1997.

Dated at Wellington this day of 1997

A E Bollard	P C Allport	K M Brown
Chairman	Deputy Chairman	Member