



COMMERCE COMMISSION

Statement of Preliminary Issues

Fonterra Co-Operative Group Authorisation Application re Kotahi Logistics

7 October 2011

11.4/13004

INTRODUCTION

1. On 13 September 2011, the Commerce Commission received an application from Fonterra Co-Operative Group Limited seeking authorisation of agreements involving Kotahi Logistics LP. Kotahi is already contracted to procure and manage Fonterra's exports by containerised ocean freight. Authorisation is being sought to allow other exporters and importers to also contract with Kotahi for freight services. Silver Fern Farms Limited already wants to join Kotahi. It is unknown at this time how many other exporters and importers may also sign up, but Kotahi is approaching a number of parties.
2. A public version of the application can be accessed on the Commission's website at: <http://www.comcom.govt.nz/anti-competitive-practices-authorisations-register/detail/725>
3. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers will be important in deciding whether or not to grant authorisation. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for authorisation progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
4. As part of its investigation, the Commission will identify the parties it considers will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks. The Commission invites interested parties to comment on the likely impact of the proposal on competition.

ANALYTICAL FRAMEWORK

5. The Commission may grant authorisation for certain practices that may otherwise breach the restrictive trade practice provisions of the Commerce Act 1986 if it is satisfied that the public benefits of the practice outweigh the lessening of competition.
6. Before assessing benefits and detriments, the Commission must first determine whether the practice would result, would be likely to result, or is deemed to result in a lessening of competition in the relevant markets. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition. To do this, the Commission establishes a number of hypothetical future scenarios:
 - with the practices in question (the factual); and

- in the absence of the practices (the counterfactual, of which there may be several).

The impact of the practices on competition is then viewed as the prospective difference between those scenarios.

7. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:
 - existing competition – the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices or, in the case of market power on the buying side, lowers prices below competitive levels;
 - potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so; and
 - the countervailing market power of buyers or sellers, in the case of market power on the buying side – the potential for a business to be sufficiently constrained by purchasers’ or sellers’ ability to exert an influence on price, quality and/or terms of supply.
8. The next step is then the assessment of benefits and detriments. The relevant detriments are those which arise in the markets where competition is lessened. In addition to adverse effects relating to price, reductions in product quality or efficiency constitute detriment. Benefits may arise in the affected markets and possibly other related markets. However, there must be a clear nexus between the practices for which authorisation is sought and the claimed benefits. Benefits can include economies of scale or scope, cost reductions or better utilisation of capacity.

KOTAHI

9. Kotahi is to procure and manage the provision of containerised freight services on behalf of contracted exporters and importers. It will not provide services in respect of bulk or non-containerised cargo. Nor will it get involved in the freight of products made or produced in New Zealand and destined for domestic markets. Kotahi will procure and manage the following services:
 - the transport of product between New Zealand and overseas ports by containerised ocean freight; and
 - the transport of containers to/from ports by road, rail or coastal shipping.
10. In procuring containerised ocean freight services, Kotahi will contract with the various international shipping lines offering services to/from New Zealand ports. Kotahi will make and manage bookings with these shipping lines on behalf of its contracted exporters and importers. The international shipping lines directly contract with port companies and other providers for services associated with the loading and unloading of containers from their ships, the storage of containers at ports and other port related services.
11. In procuring services to transport containers to/from ports, Kotahi plans to contract with road transport companies, KiwiRail and coastal shipping companies. However, Kotahi will initially outsource this transport function to a Fonterra subsidiary, Dairy Transport Logistics Limited, using its existing contractual arrangements.

12. Kotahi proposes to pool and coordinate the container freight volumes of its contracted exporters and importers through fewer ports. In doing so, it aims to leverage scale to deliver better service and potentially achieve cost savings.

PRELIMINARY ISSUES

13. Table 1 below sets out the key competition issues the Commission currently considers will be important in deciding whether or not to grant authorisation.

Table 1: Preliminary Issues

Topic	Comment and Preliminary Issue(s)
Which markets will likely be impacted by Kotahi?	There may be potential impacts on ocean freight, port services, road freight, rail freight and coastal shipping. Are any other services or markets likely to be affected?
Scale of Kotahi	The effect that Kotahi will have on the provision of containerised freight or other services is highly dependent on the number of exporters and importers that end up contracting with Kotahi.
Will Kotahi lead to less competition?	<p>For instance, could:</p> <ul style="list-style-type: none"> ▪ Kotahi’s buying power reduce prices to below competitive levels?; ▪ Kotahi facilitate collusion amongst its partners?; or ▪ Kotahi raise competitors’ costs? <p>What other adverse competition effects may result from Kotahi?</p>
What will be the likely benefits of Kotahi?	<p>Fonterra has argued that the proposal will lead to:</p> <ul style="list-style-type: none"> ▪ efficiencies in domestic freight and logistics; ▪ lower ocean freight costs through the introduction of progressively larger ships, brought about by demand consolidation and smoothing; ▪ reduced carbon emissions; and ▪ more efficient land-side infrastructure investment.
What might happen absent Kotahi?	<p>In assessing the effects of Kotahi, the Commission needs to form a view as what might happen absent Kotahi (in the counterfactual). For example, Fonterra argues in its application that, absent Kotahi, port investment to enable the arrival of bigger ships will be delayed by three years or not even occur at all, with freight instead hubbed through Australia.</p>

NEXT STEPS

14. The Commission has published a draft timeframe in which to consider the issues raised by Fonterra's application for authorisation. Any updates to the timeframe will be posted on the Commission's website at <http://www.comcom.govt.nz/anti-competitive-practices-authorisations-register/detail/725>. However, parties who wish to be kept directly informed of the Commission's consideration of Fonterra's application for authorisation can contact the Registrar, at registrar@comcom.govt.nz.
15. Parties are invited to make submissions on Fonterra's application for authorisation. Any submissions should be sent to the Registrar, at registrar@comcom.govt.nz with the reference Kotahi in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140. The deadline for submissions is **4pm on Thursday 3 November 2011**. In the absence of being advised otherwise, the Commission will assume that submissions can be made publicly available in their entirety. Refer to process document on the Commission's website for guidance on confidentiality. Note that interested parties will have a further opportunity to make submissions on a draft determination issued by the Commission.