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COMMERCE COMMISSION

Decision No. 495

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

BRAMBLES NEW ZEALAND LTD

and

GE CAPITAL RETURNABLE PACKAGING SYSTEMS LTD

The Commission:	MJ Belgrave PR Rebstock Peter Taylor
Summary of Application:	The acquisition by Brambles New Zealand Ltd of the business and assets of GE Capital Returnable Packaging Systems Ltd.
Determination:	Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to decline clearance for the proposed acquisition.
Date of Determination:	21 March 2003

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THE PROPOSAL

1. A notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") was received on 22 November 2002. The notice sought clearance for an application from Brambles New Zealand Ltd ("Brambles"), which owns CHEP (New Zealand) ("CHEP") or the ("Applicant"), to acquire the business and assets of GE Capital Returnable Packaging Systems Ltd ("GECRPS"). GECRPS trades in New Zealand under the name GE Weck-Pack.

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 notice agree to a longer period. An extension of time was sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 21 March 2003.
3. In its application, Brambles sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

Brambles New Zealand Ltd

5. Brambles own a range of businesses in New Zealand, including CHEP, which was established in New Zealand in 1974, and is involved in the supply of packaging systems (or equipment) and related services for the handling of unit loads in New Zealand. CHEP has a pallet supply operation, which is the largest part of its business but which is not the subject of the proposed acquisition.
6. Of relevance to this application, is CHEP's involvement in the supply, by way of a pooling system, of a range of stackable and nestable plastic crates, which are used in the fresh produce industry for the storage and transportation of fresh fruit and vegetables.
7. Until the merger of Progressive and Woolworths in 2002, CHEP was the preferred crate supplier to the Woolworths supermarket chain. CHEP now supplies crates to some growers supplying Foodstuffs (Wellington) and Foodstuffs (South Island) supermarkets, and some growers supplying independent retailers. CHEP is the smallest of the three crate hire companies, having approximately [ ] crates.

[1] Commerce Commission, *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*, May 2001.

GE Weck-Pack

8. GE Weck-Pack ("Weck") is the trading name of GECRPS's container packaging business in New Zealand. The Weck business was established in 1989 and was purchased by GECRPS in November 1997.

9. Weck also supplies reusable plastic crates for hire by way of its pooling system. Weck has a limited number of pallets; however, these pallets are solely used for transportation of its own crates and boxes. They are not available for general hire.

10. Prior to the merger of the Progressive and Woolworths supermarket chains in 2002, Weck was the preferred supplier of crates into Progressive stores. Weck has since become the preferred supplier to the merged entity. In addition, Weck has crates going to some Foodstuffs stores and also to independent retailers.

11. Weck has approximately [ ] crates.

OTHER RELEVANT PARTIES

Fruit Case Company

12. Fruit Case Company ("FCC") is a wholly owned subsidiary of Turners and Growers ("T&G") a produce wholesale and distribution company. FCC is the largest competitor in the reusable plastic crate hire market, having approximately [ ] crates. FCC is the major supplier of plastic crates to growers supplying Foodstuffs supermarkets, and also to independent retailers.

Turners and Growers

13. T&G is the largest wholesaler and distributor of fresh produce in New Zealand, having around [ ] of the New Zealand market. T&G's major customer is the Foodstuffs supermarket chain.

Foodstuffs

14. Foodstuffs is the largest supermarket chain in New Zealand having approximately 55% of the New Zealand grocery market. Its major brands are New World, Pak'N Save and Four Square. Foodstuffs consists of three separate, regionally based, retailer-owned co-operative companies, together with their Federation body, Foodstuffs (NZ) Ltd. The co-operatives are: Foodstuffs (Auckland) Ltd, which covers the North Island from Gisbourne, Turangi, Taumarunui north; Foodstuffs (Wellington) Co-operative Society Ltd, which covers the southern half of the North Island; and Foodstuffs (South Island) Ltd which covers the entire South Island.

Progressive Enterprises Limited

15. Progressive Enterprise Ltd ("Progressive") holds approximately 45%[2] of the New Zealand grocery market and operates the Foodtown, Woolworths, Countdown, Big Fresh, and Price Chopper supermarkets. In June 2002, Progressive purchased Woolworths (NZ) Ltd ("Woolworths")[3]. Prior to the merger, Progressive

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[2] Progressive's Website http://www.progressive.co.nz

[3] Decision 438, *Progressive Enterprises Limited and Woolworths (NZ) Limited*, 13 July 2001 - cleared
Decision 448, *Progressive Enterprises Limited and Woolworths (NZ) Limited*, 13 December,2001 - declined

operated Foodtown, Countdown, SuperValue and FreshChoice supermarkets and Woolworths operated Woolworths, Big Fresh and Price Chopper supermarkets.

THE INVESTIGATION

16. In the course of the investigation of the proposed acquisition, Commission staff have circulated the application widely within the industry, and have discussed the application with a number of parties, including:

- Foodstuffs
- Progressive Enterprises
- Turners and Growers
- The Fruit Case Company
- Carter Holt Harvey Packaging
- Visy Board
- Graeme Weck
- Vegfed
- Auckland Retail Fruiterers Association Incorporated
- Green Rebel
- NZ Hothouse
- Freshmax
- A.S. Wilcox and Sons
- Sutherland Produce
- LeaderBrand
- Several other growers
- Viscount Plastics
- CSI Produce
- MG Marketing
- Primor

INDUSTRY BACKGROUND

Recent History of Produce Packing Crates in New Zealand

17. Until the 1980s, the majority of fresh New Zealand produce was sold at auction across T&G's auction floors. In addition to the auction facilities, T&G also provided through its subsidiary FCC, wooden 'one way' fruit boxes and returnable wooden Vegiepacks (holding about six heads of lettuce) and wooden Allpacks (a smaller box suitable for spring onions, radishes, tomatoes and other non-bulk vegetables and domestic fruit).

18. In the early 1980s, Progressive, through its subsidiary Foodtown, brought pressure to bear on T&G to supply it with produce directly, rather than having to buy through the auction system. By 1983, Foodtown and other supermarkets were also purchasing their produce from an emerging group of produce brokers, or wholesalers, which were not associated with the auction system but which facilitated the movement of produce between the grower and the retailer. Later that decade, supermarkets also began buying some produce directly from growers.

19. As Foodtown and other supermarkets withdrew from the auction system and moved towards supply independent of T&G, FCC remained the only crate supplier, and as such, found its crates being used without T&G being involved in the transaction. According to

produce buyers around that time, T&G's attitude began to harden with regards to growers supplying produce directly in FCC equipment[4].

20. Partly as a result of the hardening attitude of T&G, and partly to provide some competition in the provision of crates, in 1989 Foodtown supported Graeme Weck into the market to supply reusable wooden boxes that were identical to FCC's Vegiepacks and Allpacks. In 1990, having seen plastic crates in the UK, Foodtowns' management determined that introducing plastic crates would give Foodtown a competitive advantage in the New Zealand market, given that they were, amongst other things, lower cost, more hygienic, nestable, stackable, and more durable. Foodtown approached Graeme Weck, who having geared his operation around wooden crates at Foodtown's recent invitation, was not willing to shift to plastic crates at the time. Foodtown then approached CHEP and reached an agreement whereby CHEP would import 30,000 plastic crates. Although both Weck and FCC initially ridiculed the plastic crates[5], within 18 months of CHEP importing the plastic crates, both Weck and FCC adopted plastic crates.

21. Initially there were differences between FCC's and Weck's 'deposit/refund' system and CHEP's 'daily hire' system but competitive pressure combined to rationalise charging so that the deposit/refund system prevailed[6].

22. In addition to major entry, there is one example of entry on a small scale by the Greenleaf Vegetable Container Trading Company Limited ("Greenleaf") in 1996/7. Greenleaf was a small pooling operation set up in the Central North Island by approximately 300 growers. Greenleaf's operation included 88,000 plastic crates and 500 wooden bins (also 2,000 pallets). In April 1999, there was a change in policy by T&G to account only for FCC crates passing across T&G's floor. As a result, growers putting non-FCC crates through T&G faced the risk of losing their crate deposit, as the crates were not accounted for by T&G, and were therefore more difficult to track. With the change in T&G policy, and without the support of a supermarket, Greenleaf struggled to survive and was eventually purchased by CHEP.

23. There has been very little direct change in the industry since 1993[7], which suggests that the industry is to a large extent, mature.

Plastic Crates in the Produce Industry Today

24. Three main groups use plastic crates in the fresh produce industry for the transport of their produce: growers; produce wholesalers ("wholesalers"); and produce retailers, which includes both supermarkets and independent retailers.

25. In New Zealand, fresh produce is mainly retailed through two types of channel: supermarkets and independent retailers. Table 1 shows the respective percentages of produce retailed through those channels.

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[4] Dr Hans Maurer, *A Produce Industry Perspective*, February 2003.
[5] Ibid
[6] Ibid
[7] Ibid

Table 1: Supermarket and Independents Retail Produce Sales[8]

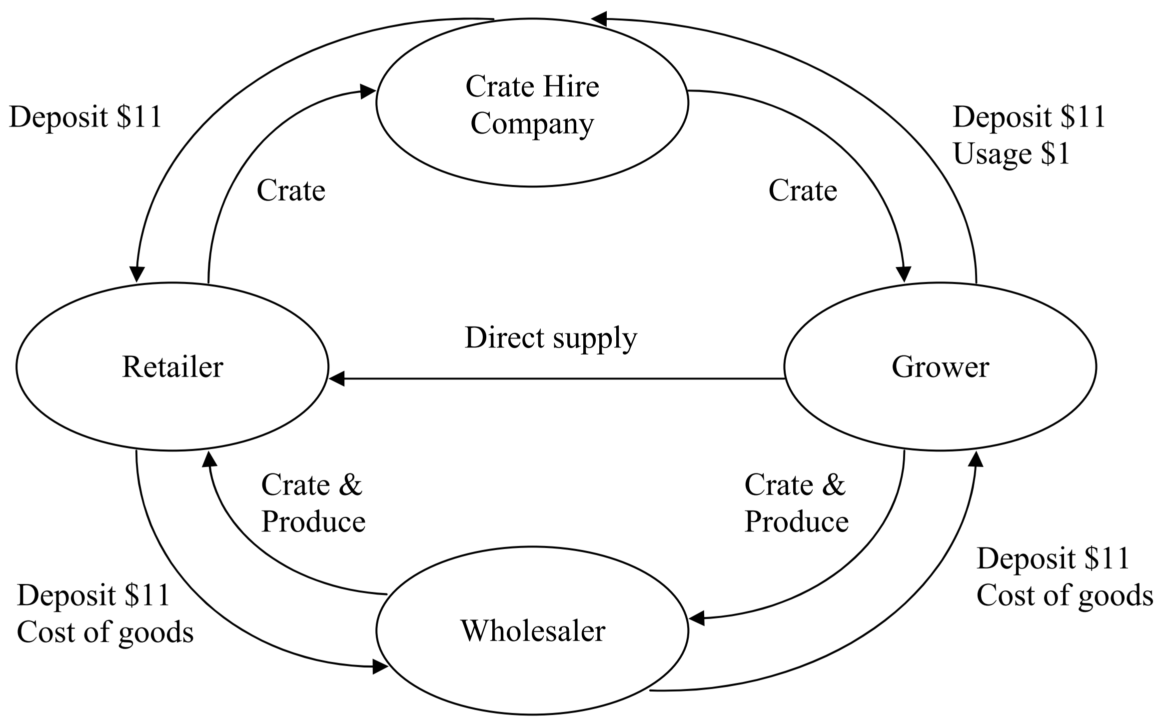
Company type	Share of retail produce sales
Supermarkets: (Progressive & Foodstuffs)	62%
Independent Retailers	38%
Total	**100%**

26. Presently, Progressive accepts only Weck crates. Foodstuffs (Auckland) accept Weck and FCC crates, while Foodstuffs (Wellington) and Foodstuffs (South Island) accept CHEP, Weck, and FCC crates. Independent retailers generally accept all three crate types according to what the supplying grower has used.

27. Crates are hired to growers as required and then transferred along the supply chain to wholesalers and retailers. On return, the crates are washed and made ready for rehiring (or issue).

28. CHEP, FCC and WECK, operate a deposit refund ("netting") system in connection with the hiring of crates by their respective customers. The cycle is illustrated in Figure 1 below.

Figure 1: Deposit and Fee Charging System



[8] Decision 438, *Progressive Enterprise Limited/Woolworths (NZ) Limited,* 13 July, 2001.

29. The crate company issues a crate to a grower and invoices the grower a usage fee and a deposit. When the grower sells his produce to a wholesaler, the wholesaler refunds the deposit to the grower and assumes liability for the crates. When the wholesaler sells the produce to a retailer, the retailer refunds the deposit to the wholesaler and assumes liability for the crate deposit. A grower may also sell directly to the retailer. When the retailer returns the crate, the crate company credits the retailer. Settlement between the grower and the wholesaler, and wholesaler and retailer generally occurs every two weeks.

30. The base price for the use of a plastic crate is $1, which may be discounted according to volume. In addition, growers are charged a deposit fee of $11 per crate. The deposit acts as an incentive for crate users to return the crate to the crate company. Growers who use large volumes of crates and who turn the crates around quickly benefit from per crate discounts, which range from [ ].

31. Growers are the only group in the supply chain who pay directly for crate usage. Wholesalers receive an administration fee from the crate companies for the handling and tracking of crates. [ ] The crate companies make the payment to the wholesalers in order to ensure the deposit/refund system works effectively.

PREVIOUS INVESTIGATIONS

32. The Commission has conducted a number of investigations involving the parties to the current proposal. Those investigations are pertinent to the analysis of this application, as they outline the Commission's previous conclusions on market definition in respect of various packaging systems. The investigations are as follows:

Screening Report: CHEP Holding Systems Ltd/Loscam NZ Ltd

33. In 1996, the Commission investigated CHEP over allegations of predatory pricing. This related to a contract with Carter Holt Harvey Tissue Group in which CHEP allegedly tendered a price for the hire of pallets which was below cost, in order to eliminate Loscam from the market. The complaint was analysed in terms of section 36 of the Act.

34. The relevant market defined was that for "the hireage of standardised pallets to various industries throughout New Zealand".

35. The Commission found that although the likely purpose was to eliminate Loscam from the market, CHEP was unlikely to be dominant in the relevant market. The Commission therefore, concluded on 16 April 1996 that a breach of section 36 was improbable, and the case was consequently registered for no further action.

Decision 298: Acquisition involving General Electric Company and CHEP Handling Systems Ltd

36. A merger between CHEP and Loscam was considered in a clearance application dated 18 June 1997. The application, however, was made by the General Electric Company, which sought clearance for General Electric Capital, a 100% owned subsidiary and owner of Loscam, to acquire CHEP. General Electric Capital had not at that time purchased Weck-Pack.

37. The acquisition of CHEP by GE Capital did not take place, and Brambles instead purchased CHEP.

38. The relevant market in Decision 298 was defined as the market for "the hire of reusable packaging containers in New Zealand". In the Commission's decision, the following points were observed:

- although high, the post acquisition market share was within the Commission's safe harbour;
- there did not appear to be any constraints on an expansion of activity by a competitor;
- a new entrant would not face onerous entry conditions; and
- the merged entity would be constrained by the ability of large users to purchase containers and operate their own pools.

Consequently, the Commission was satisfied that the acquisition was unlikely to create or strengthen a dominant position in any market.

Proposed Business Acquisition: CHEP New Zealand Ltd/The Fruit Case Company (J2582)

39. In 1998, the Commission investigated a proposed merger between CHEP and The Fruit Case Company Ltd (Fruit Case). A conclusion was reached on 27 February 1998 that the acquisition would not result, or be likely to result, in any person acquiring or strengthening a dominant position in any market and the case was consequently registered for "no further action".

40. In reaching this conclusion, the Commission also reconsidered the market definition. The market defined was that for "the hire of reusable and disposable packaging systems for the handling of unit loads in New Zealand" ("the packing systems market"). The market definition was broadened on the basis that disposable packaging systems could serve a similar function as reusable packaging systems.

41. It was considered that dominance would not be acquired or strengthened for essentially the same reasons as found in Decision 298.

Initial Report: Proposed Acquisition of Loscam and Greenleaf by Brambles (J3703)

42. In 2000, the Commission investigated the proposed acquisition of Loscam and Greenleaf by Brambles. The Commission concluded that neither acquisition would result, or be likely to result, in any person acquiring or strengthening a dominant position in any market and consequently registered the matter for "no further action". The Commission notified Brambles that the proposed acquisition was unlikely to breach s47 of the Act.

43. The market definition used was the same as that for J2582, "the market for the hire of reusable and disposable packaging systems for the handling of unit loads in New Zealand". Commission staff found that although the combined entity breached the Commission's safe harbours in certain sub-markets, it would not be able to exploit market power because of the substitutability between the different forms of packaging. In addition, it was felt that market power would be further curtailed by the countervailing power of large customers.

44. The acquisition proceeded and shortly after the Commission received a number of complaints from industry participants that CHEP had increased its pallet hire prices significantly.

45. As a result, the Commission, in November 2000, re-examined the acquisition (J4069) and concluded that CHEP's acquisition of Loscam raised a concern that a dominant position

in the market for pallet hire in New Zealand might have resulted. On the basis of legal advice on procedural matters, the Commission decided to take no further action.

MARKET DEFINITION

46. 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.*

47. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

48. The Commission defines relevant markets in terms of four characteristics or dimensions:
    - the goods or services supplied and purchased (the product dimension);
    - the level in the production or distribution chain (the functional level);
    - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
    - the temporal dimension of the market, if relevant (the timeframe).

49. The Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

50. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

51. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[9] The Commission considers this a period of one year, which is the period customarily used

[9] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission said: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

internationally in applying the *ssnip* test to determine market boundaries. The Commission takes into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

CHEP's View of the Market

52. The Applicant has defined a market for the supply of reusable and disposable container packaging, particularly for any or all of the storage, transport and/or display of fruit and vegetables ("produce"). The Applicant commissioned Charles Rivers Associates (CRA) to provide advice on the market definition and assessment.

53. CRA contended that the appropriate market definition included plastic crates, cardboard boxes and other packaging materials. CRA argued that the Commission should be extremely cautious in attempting to set the boundaries of the market by cost comparison as the products (cardboard cartons, bags and plastic crates) are differentiated and cost comparisons are difficult and complicated. They suggested an alternative approach to market definition of determining the substitutability of plastic crates and cardboard boxes (and other materials) by considering evidence of actual use of the products by lines of fruit and vegetables. They cited evidence from two wholesalers (provided at the request of the Applicant), MG Marketing and CSI International, which stated that a significant proportion of both cartons and crates were used for many lines of fruit and vegetables. At the aggregate level the MG data stated that cardboard boxes constituted 30%, plastic crates 54% and bags about 10%. CRA acknowledged that this data was quite different from the Commission's view, based on information provided by supermarkets, that 85% to 95% of produce was delivered in crates. CRA argued that as wholesalers transact most produce, the information gathered by wholesalers is likely to be representative and the most reliable information available to the Commission.

54. CRA acknowledged that for vegetables with high moisture content (referred to as wet vegetables in this report), crates are the predominant form of packaging. However, they noted that as the ssnip test is forward-looking, this does not mean the cardboard boxes are not an economic substitute for crates. CRA admitted that the substitutability of crates and boxes for these products is certainly more debateable. CRA argued against a narrow market definition of plastic crates for wet vegetables on the grounds that as wet vegetable growers are diversified, i.e. they grow both wet and other vegetables, that it would be impractical for a crate operator to price discriminate or to charge one grower more for their wet vegetables than for others. They also noted that if price discrimination were possible, they would expect to see it occurring.

The Commission's View of the Appropriate Market

55. The Commission considers that close substitute products are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in relative prices. In considering whether cardboard boxes are an economic substitute for plastic crates, the Commission has considered the current evidence of their use for the transport of domestic produce from growers to wholesalers and retailers in New Zealand, and the relative cost of the hire of plastic crates and the purchase of cardboard cartons.

56. It is important to distinguish between domestic and imported or exported produce. Returnable plastic crates are not currently used for importing or exporting fresh produce due to the high cost of returning packaging from or to other countries. Therefore, the proposed acquisition will not affect the transport of exported and imported produce.

Cardboard boxes are used extensively for the export and import of produce. It is important to ensure that data regarding the use of cardboard for transport of fresh produce does not include exported or imported produce, as this is not part of the relevant market.

57. In Decision 448, the Commission estimated that supermarkets held about 60% of the produce market. Information from both supermarket chains, received as part of this investigation, suggests that the vast majority of produce is received in plastic crates. Progressive have stated that almost all of their produce is received in re-usable plastic crates. Foodstuffs have stated that 80% to 90% of produce is received in plastic crates, with some variation depending on the season.

58. Due to the number of independent retailers, it is difficult to obtain information directly from them on how they receive produce. MG Marketing, a wholesaler to both supermarkets and independent retailers, did not observe any difference between the use of plastic crates by independent retailers and the supermarkets. A major Auckland independent retailer, Green Rebel stated that they received about 90% of their produce in crates. In their view most other independent retailers were likely to receive a similar proportion of produce in plastic crates, although they noted upmarket premium produce retailers were likely to receive a greater proportion in cardboard. However, ARFAI (Auckand Retail Fruiterers Association Incorporated) estimated the use of non-returnable containers (including cardboard boxes) as 35% of the total containers used. ARFAI estimated that independent retailers comprise a substantial proportion of FCC's returnable crate business and noted that independent retailers do not generally have the power to specify what containers produce will be packed in.

59. There is contradictory information on the extent to which cardboard boxes are used as a substitute for plastic crates. The information from the supermarkets, an independent retailer and the cardboard box manufacturers suggests little actual use of cardboard boxes for transport of domestic produce. Information supplied by the Applicant from two wholesalers and ARFAI suggests that cardboard boxes are used across a broad range of domestic produce. The Commission is inclined to weigh more heavily the evidence from supermarkets on the basis that the supermarkets are the ultimate recipients of produce and have a 60% share of the produce market. There is also evidence from Green Rebel that independent retailers use plastic crates in similar proportions to the supermarkets. CHEP estimates MG Marketing and CSI's combined wholesaler market share to be [ ]. Furthermore, the evidence from the cardboard box manufacturers (discussed below) corroborates the supermarket information.

60. The Commission considers that evidence that most or almost all produce is currently stored or transported in plastic crates may indicate limited substitutability between plastic crates and other packaging such as cardboard boxes. However, even if other types of packaging were to be more widely used in practice, this fact does not itself indicate that other types of packaging are economic substitutes for plastic crates. In order for cardboard boxes or other types of plastic crates to be economic substitutes for plastic crates, then a 5% price increase in plastic crates would have to induce sufficient switching to make such a price increase unprofitable for a hypothetical monopolist. Therefore, the use of cardboard boxes in some instances, such as for high value/low volume premium produce, does not itself indicate that cardboard boxes are economic substitutes for plastic crates for most other produce. In order to consider the substitutability of cardboard boxes for plastic crates, the Commission has considered evidence on the relative costs of plastic crates and cardboard boxes.

61. Cardboard manufacturers interviewed by the Commission stated that there is little use of cardboard for domestic produce, almost all cardboard being geared towards export. The cost of cardboard ranges from around [ ] for a waxed cardboard box to [ ] for an export apple box and [ ] for a standard box (based on a high volume run). The appropriate cardboard comparator for a plastic crate was suggested to cost about $1.50. Visyboard estimated that the hire charge for plastic crates would have to rise to about $1.70 before cardboard would become a suitable alternative. Visyboard was willing to install box making machinery at the sites of high volume customers, with a choice of an upfront cost of [ ] or a per box charge in the order of [ ]. CHH noted that it had no product in development to compete directly with plastic crates. CHH noted that statistics in the clearance application were incorrect as most cardboard uses discussed in the application were for the export market.

62. Some caution needs to be exercised in making cost comparisons between plastic crates and cardboard boxes, as costs may vary between:

- the level of the market: grower, wholesale and retail,
- different types of produce; and
- different regions and locations.

63. It is possible that cost savings at one level may impose additional costs downstream. For example, a grower may prefer to use plastic crates from a variety of firms, whereas supermarkets may seek to limit the variety of plastic crates to reduce the administration costs of crate management. Progressive specify produce must be supplied in Weck crates, while Foodstuffs (Auckland) limit crate variety to Weck and FCC. Nonetheless, the Commission considers it worthwhile to estimate the cost of crates and boxes to the grower, to provide some indication as to whether substitution may occur in response to a ssnip, and to test the market data on the use of plastic crates and cardboard boxes.

64. The unit cost of crates ranges from approximately [ ] for high volume users to [ ] for remote users. CHEP stated their average hire charge for produce customers is [ ]. The cost of a cardboard box according to cardboard box manufacturers is approximately $1.45 to $1.50. Growers have to bear the additional cost of capital for the deposits on plastic crates. On the basis of a two-week period for the crate to pass from the grower to the wholesaler and a cost of capital of 15%, this may add about $0.06 to the cost of hiring a crate. In addition, a Deloitte's study[10] for Vegfed estimated that:

- the cost to the growers from the administration cost was $0.165 per crate;
- crates losses cost $0.046; and
- the labelling cost was $0.025.

65. In total, this suggests the addition of $0.30 to the hire charge to allow for the total cost of crates to the grower. This suggests crate costs to a high volume grower may be approximately [ ] to a remote grower. A potential cost saving to growers from the use of plastic crates is the ability to pick produce in the field directly into plastic crates. Plastic crates are able to withstand high humidity cool stores and the use of ice for cooling products. Both of these practices are common for green vegetable growers.

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[10] This study attempted to estimate the total cost of the hire of plastic crates to the grower. However, the results of the study are not appropriate to compare with the cost of cardboard boxes, as the costing includes items such as freight and pallet hire, which are also costs for cardboard boxes. Therefore, the Commission has used cost estimates where it is considered appropriate and relevant to the costing of the hire of plastic crates.

66. Cardboard boxes have additional costs such as additional strapping on pallets, extra storage costs for ready-made boxes (as they cannot be stacked inside each other) and the cost of box making. Based on strapping costs estimated for plastic crates by Deloitte's, the Commission estimates the additional cost for strapping to be $0.05.[11] On the evidence provided by a cardboard manufacturer, the cost of a box machine for a high volume run, on a per box basis, is estimated to be [ ]. This estimate may understate costs for lower volumes, as for lower volumes, it is uneconomic to use box-making machines due to the high fixed costs. The cost of hand-making boxes is likely to be a higher cost on a per unit basis for a small volume of boxes when compared with the unit cost of a box making machine for a high volume of boxes. This suggests that the cost of cardboard boxes is about [ ] per box. This is consistent with information received from Visyboard. Based on this cost comparison, a 5% price increase in the hire of plastic crates would not result in plastic crate prices rising to the cost of cardboard boxes, even for remote or high cost growers.

Table 2: Summary Table of Comparison of Plastic Crate and Cardboard Box Costs

Cost Component	Crate	Box
Hire Charge/Price of Box	[ ]	$1.45
Cost of capital on crate deposit	$0.06	
Administration cost	0.165	
Labelling	0.025	
Cost of crates losses	0.046	
Box making		[ ]
Extra strapping		0.05
Total cost to grower	[ ]	[ ]
Impact of 5% SSNIP on Plastic Crate	[ ]	

67. The substantive cost difference to the grower between plastic crates and cardboard boxes suggests that a small but significant price increase may not lead to switching from plastic crates to cardboard boxes. However, the cost to the grower is only one, albeit very significant element, in assessing the substitutability of plastic crates and cardboard boxes. The different attributes of plastic crates and cardboard boxes and their downstream costs and benefits need to be considered.

68. The costs and benefits of crates versus boxes to downstream users such as wholesalers and supermarkets are the transport costs and the costs of making-up pallets for delivery to supermarket branches. The analysis does not take account of the different attributes of the products such as the ability to brand cardboard boxes. In terms of transport costs, there are two potentially offsetting effects. It has been argued that it is possible to stack more cardboard boxes than plastic crates on a single pallet due to their design; on the

[11] Based on a 50% increase of strapping costs for plastic crates.

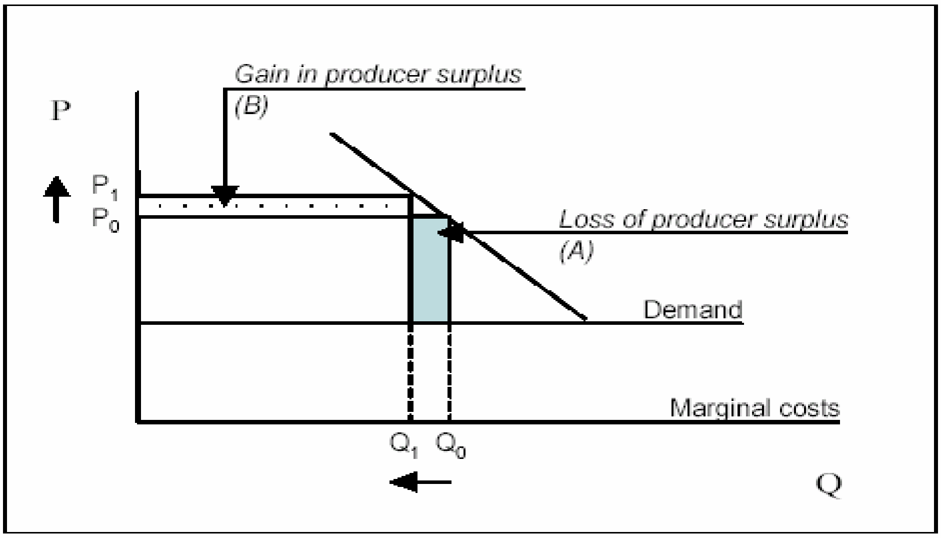
other hand, pallets of plastic crates can be stacked on top of each other for transport and storage.

69. A large scale grower [ ] stated that plastic crates were [ ] lower cost than cardboard boxes when considering the total cost from grower to delivery to supermarket. This suggests that plastic crates may have lower transport costs. Progressive has argued that plastic crates are more convenient and lower cost than cardboard boxes for distribution to supermarket branches, as plastic crates are a standard size and this allows produce from different sources to be stacked on the same pallet. In contrast, cardboard boxes come in a range of sizes, so that produce from different sources is less able to be stacked on the same pallet. This results in smaller pallet loads and higher unit costs. In sum, there appears to be some evidence that there are cost and convenience advantages in the use of plastic crates for the transport of produce and the distribution of produce to supermarket branches.

70. There are also non-cost factors to be considered in a comparison of the substitutability of cardboard and plastic crates. Both cardboard boxes and plastic crates are able to be branded, plastic crates by the addition of a sticker on the crate and cardboard boxes by printing. However, cardboard boxes appear to be seen as a better container for branding purposes. It should be noted that cardboard boxes are not generally used for display of produce in supermarkets and therefore cardboard is of little value in terms of branding to end-consumers. It is possible that growers perceive some benefit in the display of their brand at wholesaler and supermarket distribution centres. Due to their rigid construction, plastic crates are believed to result in less damage to produce for most fruit and vegetables, although, cardboard boxes can be reinforced through additional strapping on each pallet load.

71. The above discussion provides some evidence on the cost and other differences between plastic crates and cardboard boxes. The Commission considers that it is worthwhile to estimate the extent to which a hypothetical monopolist over crates would have to lose business in order to make a 5% price increase unprofitable. In order for a 5% increase in price to be profitable, the increase in profit from the increase in prices on the business that remains must outweigh the loss of profit from customers who no longer buy the service.

Figure 2: Extent of Switching Required to Discipline the Merged Entity[12]



72. CRA on behalf of the Applicant submitted a calculation in relation to assessing the extent of switching required to constrain a merged entity. On the basis of price and cost information provided by CHEP [ ], CRA estimated the point at which a 5% price increase would be unprofitable is [ ]. The Commission considers that this calculation also provides a reasonable indication of the volume change a hypothetical monopolist would need to experience in order for a 5% price increase to be made unprofitable. The data from CHEP should provide a reasonable guide to the costs of a hypothetical monopolist. That is, if a hypothetical monopolist of plastic crates were to raise prices by 5%, it would need to suffer a loss of volume of about [ ] to make the price increase unprofitable. The size of this estimate suggests that some switching at the margin may well be insufficient to constrain the price of plastic crates to competitive levels. A real and substantive switching from plastic crates to other packaging would need to take place, in order for cardboard boxes to be considered economic substitutes.

73. In reaching a view on the market definition, the Commission also takes into account supply-side substitutability. As noted in *Practice Note 4*, if product switching requires a significant investment in sunk costs by other suppliers, then these suppliers could not be considered to be existing competitors in the market. The Applicant has not identified any supply-side substitutability. There do not appear to be any existing suppliers who could move into the supply of plastic crates for hire without significant investment in sunk costs, and therefore there do not appear to be any supply-side near-entrants to the market.

74. In reaching a view on the market definition, the Commission has considered that:

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[12] CRA Memo to Commission, 11 March 2003. The Commission notes that the 'demand' and 'marginal costs' labels are incorrectly positioned.

[14] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).

- information from the supermarkets, an independent retailer and the cardboard box manufacturers suggests little actual use of cardboard boxes for transport of domestic produce.
- the cost of hiring plastic crates is considerably lower than cardboard boxes and a 5% increase in the price of plastic crates would not raise the cost of plastic crates to that of cardboard boxes.
- transport and distribution costs appear to be lower for plastic crates than cardboard boxes; and
- it would take a significant [ ] rather than a marginal switch away from plastic crates to render a 5% price increase unprofitable for the merged entity.

75. Based on this evidence the Commission considers the relevant market to be the market for the hire of reusable plastic crates for the storage and domestic transport of fresh NZ produce.

76. An alternative market definition to both definitions discussed above is the market for reusable plastic crates for the storage and transport of NZ wet vegetables. This market definition would be based on the particular problems wet vegetable growers would have in switching from plastic crates to cardboard cartons. Due to the high moisture content of wet vegetables, the only suitable cardboard box is a waxed cardboard box. Waxed cardboard boxes are expensive [ ] per box and are not currently recyclable. Therefore, cardboard boxes are not an economic substitute for plastic crates in respect of wet vegetables. However, in order to define a separate market for plastic crates for transport of wet vegetables, the Commission would need to be satisfied that it would be possible for a hypothetical monopolist to profitably raise charges to growers of only wet vegetables or to price discriminate. The Commission does not consider that it is necessary to reach a view on this issue, as any competition concerns with regard to the impact of the merger on wet vegetables will be addressed in the market for reusable plastic crates for the transport and storage of produce.

Geographic Market

77. The Commission accepts the Applicant's proposal that the relevant geographic market is national. While there is some evidence of differences in prices in different parts of the country, due to the costs of freight to remote locations, all three crate hire businesses compete on a national basis, as fresh produce is distributed to retail locations across the country.

Functional Level

78. The relevant functional level is that for the hire of reusable plastic crates for the distribution of fresh produce through the supply chain.

Conclusions on Market Definition

79. The Commission has concluded that, for the purposes of this application, the relevant market definition is:

- The national market for the hire of reusable plastic crates for the transport and storage of fresh New Zealand produce.

COMPETITION ANALYSIS

Substantially Lessening Competition

80. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> 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.

81. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[14] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[15]

82. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[16]

83. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);
- the nature and extent of the contemplated lessening; and
- whether the contemplated lessening is substantial.[17]

84. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

85. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent,

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[15] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* (1993) 1 All ER 289.

[16] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

[17] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* (1987) 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* (1988) 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* (1990) 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

86. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

87. The Commission uses a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

88. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[18] In its Application for Clearance, CHEP advised the Commission that [ ].

89. [ ]

90. [ ]

91. [ ]

92. [

[18] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

].

93. Furthermore, the Commission notes that CHEP is presently supplying crates to growers, Foodstuffs (Wellington) and Foodstuffs (South Island). In addition, as set out in Table 1, independent retailers account for around 38% of produce sales. The Commission therefore considers [

].

94. Given the sunk cost investment CHEP has made in its crates and also [

] should the merger not proceed.

95. [

].

Conclusion on Counterfactual

96. [

] the Commission is of the view that there would continue to be three players, whether CHEP is owned by Brambles or an independent party, in the crate hire market. Therefore, the Commission proposes to use the status quo as the counterfactual.

Potential Sources of Market Power

97. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

98. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one-year time frame.[19] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

[19] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

99. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

100. The supply-side characteristics of differentiated product markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

101. Whilst there are some variations in the hire services provided by market participants, those variations are not so marked as to warrant a specific discussion of service differentiation.

ANALYSIS OF EXISTING COMPETITION

Introduction

102. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subjects of the analysis in this section.

Scope for Unilateral Market Power

Introduction

103. An examination of concentration in a market post acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

104. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other

different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[20]

105. In determining market shares, the Commission will take into account the existing participants (including 'near entrants'), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission's 'safe harbours', an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Existing Participants

106. Presently, three firms compete in the market for the hire of reusable plastic crates for the transport and storage of fresh New Zealand produce. The three participants are CHEP, Weck (preferred supplier agreement with Progressive), and FCC (a key supplier to Foodstuffs). Accordingly, the proposed acquisition would result in a reduction of market participants from three to two.

Safe Harbours

107. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where 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 or associated persons) has less than in the order of a 40% share; or

- where 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%.

Market Shares

108. Market shares based on the number of customers each crate firm services does not necessarily reflect the competitive constraint a crate firm places on competitors in the market. As discussed in the Market Definition and Barriers to Entry sections, the Commission considers the investment in a supply of crates to be a significant sunk cost that acts as a barrier to entry. Therefore, CHEP's crate supply may be difficult for a new entrant to duplicate, making CHEP's potential ability to supply the market a key factor in the existing state of competition between the three crate hire firms.

109. Whether the Commission adopts a conservative approach and uses market shares based on capacity, or whether it uses those submitted by the Applicant based on percentage of

[20] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

the produce market supplied, the Commission considers it is the constraint posed by CHEP's crate supply that is the critical aspect of existing competition in the market. Market shares for both measures are shown in Table 3.

Table 3: Estimated Market Shares for the Hire of Reusable Plastic Crates

Firm	Market share based on % of supply for produce[21]	Market share based on crate capacity	Capacity (number of crates)
FCC	[ ]	[ ]	[ ]
CHEP	[ ]	[ ]	[ ]
Weck	[ ]	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**	**[ ]**
Total	**100%**	**100%**	**[ ]**

110. Table 3 indicates that using either the market share submitted by the Applicant or a market share based on crate capacity, the merged entity would have a market share outside the Commission's safe harbour guidelines where the three firm concentration ratio is above 70%.

111. Market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

State of Existing Competition

112. Current competition in the market is primarily between Weck and FCC, with CHEP acting as a fringe player. The acquisition of Woolworths by Progressive resulted in CHEP losing its agreement to supply Woolworths, its biggest customer. CHEP submitted that its market share was [ ] before the merger, falling to [ ] post merger. While the merger represents a small degree of aggregation in terms of market share as submitted by the Applicant, the Commission considers it is the potential constraint CHEP's supply of crates represents that needs to be assessed in the competition analysis.

[21] These are the market shares submitted by the Applicant. On the basis of the Commission's investigation, and information received from Weck and FCC, CHEP has an [ ] market share. However some of this period includes revenue from Woolworths.

[24] Commission file note, Progressive, 4 March 2003.

CHEP

113. CHEP supplies some crates to Foodstuffs (Wellington) and Foodstuffs (South Island). In addition, CHEP supplies independent growers and retailers, which make up 38% of the total produce market. CHEP also provides a significant volume of crates to a major wholesaler, MG Marketing. CHEP's recent reduction in market share highlights the vertical split in the supermarket segment of the market post the Progressive/ Woolworths merger. The segment is split between growers who supply Progressive and growers who supply Foodstuffs. While growers do supply both supermarket chains, the trend for large growers is to establish preferred supplier arrangements with one supermarket or the other. The split leaves only a portion of the supermarkets' produce demand (through Foodstuffs Wellington and Foodstuffs South Island) as currently subject to competition from a third crate company.

114. While there is minimal aggregation in the market in terms of the market share submitted by CHEP, [ ], the Commission's concern is the effect on the market of the removal of CHEP. Despite its relatively small market share, CHEP's ability to potentially supply a [ ] share of the market based on crate capacity [ ], acts as a constraint on the other two market participants. Also, CHEP's crate depot system gives it sufficient geographic scale to transport crates to and from the South Island (see Barriers to Entry section).

115. [ ] submitted that given CHEP's capacity, CHEP is a realistic alternative to Weck or to FCC and provides a degree of constraint on Weck and FCC. [ ]

116. The ability to use CHEP as a crate provider is a credible threat for [ ]. [ ] indicated [ ] of its produce goes to Progressive. [ ]. The presence of a third crate company gives [ ] the ability to threaten to switch its non-Progressive produce to CHEP as a negotiating lever with Weck.

117. Progressive requires growers and wholesalers to provide produce in Weck crates and does not accept produce in CHEP or FCC crates. Progressive stated that accepting crates from a single crate company leads to lower administration and crate inventory costs. In the past, according to Stuart Johnston, Divisional Manager of Produce, Progressive accepted all three companies' crates and found maintaining control over the crates and returning the crates was an "administrative nightmare".

118. In interviews with Progressive, Stuart Johnston stated: "CHEP is not providing very much of a constraint to us, but they do to the general crate market {independent growers and retailers}."[24] With [ ] However, as [ ] and Progressive indicate, CHEP does provide a viable alternative to independent growers and retailers. While Progressive dictates to its growers and wholesalers the type of crate it will accept, growers not supplying Progressive appear to benefit from the presence of three independent crate companies. Although, Progressive may be able to constrain Weck prices due to the threat of switching to CHEP. While CHEP may not be a credible constraint for the entirety of Progressive's produce supply , it does provide an

important third option for growers supplying independent retailers as indicated by [ ] and independent retailers interviewed by Commission staff.

119. CHEP is likely to provide some constraint on FCC, on both their Foodstuffs and independent retailer business. While, it is true that growers who use T&G as wholesalers have strong incentives to use FCC (and in practice do so), it is possible for growers to switch to other wholesalers such as MG and use CHEP crates to supply Foodstuffs (Wellington), Foodstuffs (Auckland) and independent growers. It is possible that Foodstuffs (Auckland) would consider accepting crates from CHEP and therefore the ability of CHEP to contest this business may provide some constraint on the other two firms.

120. The Commission is of the view that, to some extent, CHEP provides a competitive alternative to Weck and FCC. CHEP's presence in the market also acts as a deterrent to Weck and FCC engaging in tacit market sharing. The market division created by FCC supplying Foodstuffs and Weck supplying Progressive may provide a convenient separation for the two crate firms to use post acquisition as the boundary for tacit market sharing.

<u>Weck</u>

121. Weck provides crates to independent retailers, Foodstuffs, and Progressive. Weck is Progressive's preferred supplier, and as such, Progressive accounts for [ ] of Weck's business. [

]

122. [

]

<u>FCC</u>

123. FCC supplies crates to independent retailers and to the Foodstuffs supermarket chain. FCC supplies the majority of crates going through the Foodstuffs chain, particularly to Foodstuffs (Auckland). As a subsidiary of T&G, FCC supplies T&G with the majority of crates that go through T&G's operation. T&G accepts crates from other crate companies, but it T&G does not account for them. As a result, growers using non-FCC crates and using T&G as their wholesaler, face the risk of losing their crate deposit. This is because the crates are not accounted for by T&G, and are therefore more difficult to track.

124. In describing T&G policy, CHEP stated in its clearance application: "As T&G will only invoice FCC crates…and not other companies' crate deposits – this effectively prevents

other crate companies selling through T&G…This can be illustrated by T&G's decision in 1999 to change the way its hire crates would be accounted for through their market system. CHEP (and other crate suppliers) were advised that individual crate companies would have to establish trading arrangements with the receiver of the crates, i.e. the supermarkets. But for FCC crates, T&G would continue to record the deposit value on the customer produce invoice. As Foodstuffs wanted all hire equipment charged on the produce invoice (i.e. to avoid two invoices for the produce and the crate), T&G was required to supply only in FCC crates."

Conclusion on Existing Competition

125. The Commission considers that despite CHEP's low market share in terms of the percentage of the market it supplies, CHEP's excess capacity provides some degree of constraint on existing market participants. The level of constraint provided by CHEP for growers supplying Progressive and Foodstuffs (Auckland) is limited. However, for growers supplying independent retailers and Foodstuffs (South Island) and Foodstuffs (Wellington), CHEP is a significant competitive alternative in the market.

CONSTRAINTS FROM MARKET ENTRY

Introduction

126. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

127. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

128. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

129. As the barriers to entry and countervailing power are inextricably linked in this market the Commission intends to directly assess the two areas.

130. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

131. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

132. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

133. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

The "LET" Test

134. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition, which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

135. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

136. In general, it is the post-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

<u>Growers</u>

137. The Commission interviewed a number of growers during its investigation. The Commission also received a number of submissions from growers and industry participants in response to the Applicant's request to comment on the effects of the proposed merger on the market. The Commission has considered these responses in the course of its analysis.

138. Growers do not always limit supply of produce to their own regions and therefore require a crate hire company with wide geographic coverage. [ ] stated growers sell produce throughout both the North and South Islands. [ ], an Auckland based grower, stated, "we are a fast turn around user, I send {crates} to the South Island where they are retrieved.[26] To supply crates to growers selling produce across New Zealand a crate hire company needs to be able to both supply and recover crates in an efficient manner.

139. Other growers interviewed in the course of the Commission's investigation indicated a consortium of growers would need to establish a crate operation capable of delivering

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[26] Commission file note, [ ]

and retrieving crates from both the North and South Island. The Commission considers entry smaller than this is unlikely to offer a competitive constraint on a national crate hire firm.

140. A consortium of large growers could potentially start a crate hire company. [ ] stated that if crate prices did rise post acquisition, the only option for growers would be to start their own crate pool.[27] However, the number of growers in the market makes for difficulties in successfully establishing a consortium capable of investing $5 to $10 million in a crate hire company. [ ] stated: "Does take a fair bit to get growers together and a fair amount of capital—say $5 million plus. Growers would probably be a little reluctant to do anything there…to get the growers to come up with that sort of money is difficult."[28] In addition, a grower consortium would also require an arrangement with a major supermarket to offset the sunk cost problem.

141. A consortium [ ] made an initial bid for Weck that was later rejected in favour of CHEP's bid. In interviews with Commission staff, these parties stated that they would not consider de novo entry, as without a contract with a supermarket, a grower consortium would face the sunk cost risk of investing in a supply of crates and the difficulty of establishing a business from scratch.

142. On the balance of probabilities, the Commission considers it unlikely a new crate company started by a consortium of growers would enter the market without the support of a supermarket.

<u>Wholesalers</u>

143. The Applicant submitted that a large wholesaler that wished to vertically integrate, as T&G has, is a likely entrant into the crate hire market. MG Marketing has made submissions to the Commission stating it would enter the market in the event of an increase in crate hire prices.

144. MG Marketing stated it would be willing to enter the market if the behaviour of the merged entity provided a reason to enter.

> "Also, in MG's case, because we are vertically integrated we can manage the sunk cost risk through our relationship with our shareholder growers without the need for an arrangement with a supermarket. Therefore, taking all these factors into account, no I do not believe an arrangement with a supermarket is 'necessary'; although it may well be preferable."[29]

145. However, previously [

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[27] Commission file note, [ ]
[28] Ibid
[29] Letter from MG Marketing, 5 March 2003

] Tom Treacy, Chief Executive of MG Marketing, stated: [

]

146. Regardless of the means of entry, based on the evidence before the Commission, it is apparent that wholesalers require the willingness of a supermarket to accept their crates in order to offset the sunk cost risk involved in purchasing a supply of crates. Tom Treacy stated: [

]

147. A condition of Progressive's preferred supplier arrangement with Weck is that Weck will site its crate depots near Progressive's distribution centres. [

].

148. The lease specifies that [

]

149. [

]. However, while produce wholesalers are logical entrants into the crate hire market, the Commission is of the view that without the willingness of a supermarket to accept its crates it is unlikely wholesalers will, of their own accord, enter the market owing to the sunk cost risk.

<u>Supermarkets</u>

150. As the largest players in the crate supply chain, Progressive and Foodstuffs are the most likely parties to support a new entrant. Under the current system, Progressive and Foodstuffs do not bear the direct cost of crate hire. In the short term growers are likely to absorb the cost of increased crate hire prices. However, in the long term, as input costs to produce growers increase, it is likely that these costs will be passed through the supply chain. An increase in crate hire fees will therefore result in increased produce costs for supermarkets. Both Progressive and Foodstuffs indicate they are attuned to cost increases in their respective supply chains and seek to increase efficiencies. In the event of the merged entity raising crate hire prices, Progressive's produce would become more expensive than Foodstuffs' if FCC did not also increase prices.

151. Stuart Johnston stated: "If we saw our cost of operations going up because of the merger we would probably seek alternatives, we have Weck on site for economies of handling

equipment and transportation. If the acquisition caused our costs to go up then we would be looking at alternatives, no doubt about it.”[32]

152. The question is at what percentage increase in produce costs would Progressive or Foodstuffs take action to offset the competitive disadvantage of higher input costs in their supply chain and support new entry into the market?

153. A 5% increase in crate hire fees might result in an increase of approximately 0.15%[33] in the cost of produce for supermarkets. Weck has an annual turnover of [ ], and given that Progressive constitutes [ ] of Weck’s business, the imposition of a ssnip to the price of crate hire, assuming growers pass the increase through the supply chain, would therefore see an increase in the cost of Progressive’s produce of [ ] per annum. The issue is whether such a relatively small increase in produce prices for one supermarket, in the absence of such an increase to the other supermarket, is enough of an incentive to cause the supermarkets to support new entry.

154. Stuart Johnston stated: [ ] While Progressive was not able to quantify the level of increase required to offset the efficiencies it claims, the Commission considers that a price increase of 5% might be insufficient to offset the efficiencies Progressive gains by using a single crate provider.

155. To support a new entrant, Progressive would need sufficient financial incentive to enter into a contract with a third party and have the confidence the third party could operate an efficient crate hire operation. Wholesalers like MG Marketing, Freshmax and CSI have both the reputation and industry experience to gain supermarket support to enter. A new player outside the produce industry is unlikely to have the reputation necessary to gain the confidence and support of a supermarket. From the evidence before it, the Commission does not consider it likely an entrant outside the produce industry would enter the market.

156. Written contracts are unusual in the produce industry. Foodstuffs and Progressive conduct most of their produce related operations on the basis of verbal agreements.

157. The Commission was advised [ ], and the Commission accepts, that a new entrant into the market would require at least 600,000 crates to supply a major supermarket.[35] [ ] [ ] made these comments in relation to a crate hire firm expanding from an existing presence in the market.

158. Barriers to entry are likely to be higher for a new entrant than the barriers to expansion for an established crate hire firm. A new entrant would not only have to invest in a supply of crates but would also have to invest in crate washers and depot sites.

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[32] Commission file note, Progressive, 3 Dec 2002

[33] Based on crate hire charges forming about 2.5% to 5.0% of wholesale charges, and approximately 1.0% to 3.8% of retail costs [ ]. A 5% price increase will therefore increase charges by 0.10 to 0.20%.

[35] Commission file note, [ ].

159. A long-term contract imposes a number of costs that a supermarket like Progressive would have to consider before entering into a contract with a new entrant. The cost of monitoring service levels could potentially increase, as the supermarkets' ability to threaten the new entrant with switching crate providers is constrained post contract. To address the risks regarding service quality would require a detailed contract, and therefore up-front negotiation and transaction costs and the ongoing cost of monitoring the delivery of service according to the contract. The supermarket may also not be able to take advantage of any decrease in crate hire prices due to the contractual arrangement with the new entrant.

160. The addition of a new crate company's capacity into the market may cause crate hire prices to decrease, as the existing firms compete to gain market share. A supermarket in a contractual arrangement with a new entrant would not be able to take advantage of lower crate hire prices. Its competitors would be able to take advantage of lower prices, putting the supermarket with the contract at a competitive disadvantage. Stuart Johnston stated: "If we encourage new entry with a contract we pay more for crates or a crate company loses money."[36] Duane Day, Produce Manager, Foodstuffs (South Island) stated: "We wouldn't want to get into the crate business" and also noted they avoid entering into contracts in the produce industry.[37]

161. As an additional cost of entering into a contract, a crate hire firm faces the risk of the supermarket breaking the contractual arrangement. Graeme Weck in an interview commented on the likelihood of new entry via a contract stating: "It {entry} is very difficult. To service a main client—you need to spend something like $10-$12 million. If you went along to Progressive and say will you give me a contract for the next 10 years and we'll start a new crate company with a new design or a new generation crate—I've been approached to do it{in the past}—you are not going to get that sort of contract from a supermarket chain". [38]

162. A supermarket (using Progressive as an example), by supporting new entry with a long-term contract, has to weigh the risk and transaction costs of entering into a contract against the [ ] it will save in produce costs as a result of using a crate hire firm whose crate hire fee is 5% cheaper.

163. The Commission recognises that supermarkets are aggressive competitors and are motivated to seek out efficiencies in their supply chains. However, the Commission considers it unlikely that a supermarket would support entry in response to a 5% increase in crate hire prices. A single supermarket facing increased produce costs as a result of a 5% increase in crate hire prices is unlikely to respond due to the small proportion the crate hire charge constitutes as a percentage of the total cost of produce and the risks of entering into a long term contract with a supplier.

Extent of Entry

164. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes,

[36] Commission file note, Progressive, 14 March 2003.
[37] Commission file note, Foodstuffs File Note, 21 Jan 2003
[38] Commission file note, Graeme Weck, 7 March 2003

or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

165. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that “toe-hold” position may be difficult because of the presence of mobility barriers, which may hinder firm’s efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the ‘extent’ of entry.

<u>Small Scale entry</u>

166. Small scale entry to the crate hire market has occurred in the past, as discussed in the Industry Background section. Greenleaf entered on a regional basis in the Central North Island around 1996. Greenleaf was unable to sustain its entry and was purchased by CHEP in 1999.

167. As discussed in the section on Likelihood of Entry, growers often sell produce to both the North and South Island. Such growers prefer to deal with a crate hire firm that operates on a national scale, so that they can ensure a continuous supply of crates. While a small localised closed loop system is possible, it is only feasible for those growers supplying the proximate region.

168. Without sufficient geographic scope, a small-scale entrant may face difficulty relocating its crates between the North and South Island if it was supplying crates to growers that supply in more than one geographic region. As such, a small-scale entrant’s ability to provide a continuous supply of crates to its grower customers would be hindered.

169. As the existing participants operate on a national scale, the Commission is of the view that a small scale entrant would provide minimal constraint on the merged entity.

<u>Large Scale entry</u>

170. Historically, there were two major entrants to the crate hire market, Graeme Weck and CHEP. As discussed in the Industry Background section, Weck was encouraged to enter the market by Progressive (Foodtown) and entered with wooden crates. CHEP was also encouraged to enter by Progressive except with plastic crates.

171. When Foodtown decided to switch to plastic crates it approached Graeme Weck but as only 18 months prior he had geared his operation around wooden crates, he was unwilling to switch to plastic. Progressive then invited CHEP to supply plastic crates, as the technology was new to the produce industry and offered many benefits over the existing wooden crates, giving CHEP a competitive advantage.

172. The Applicant submitted that as historical entry has occurred in the market, barriers to entry cannot be considered high. The Commission notes that the crate hire market has matured considerably since Graeme Weck first entered the market. In addition, the fact that having encouraged Graeme Weck to enter, Progressive soon after invited CHEP to enter, illustrates that without a medium term contract with a supermarket, entry is risky. Further, as plastic crates were such a radical improvement over wooden crates, CHEP was largely able to mitigate the risk of its sunk cost investment through the competitive

advantage provided by the plastic crates. Plastic crates are now established technology, and there is sufficient capacity to satisfy crate hire demand.

173. The Commission is of the view that the support of a supermarket is critical for a new entrant. Stuart Johnston, of Progressive noted: “entry is not difficult—it is only money. To enter you would need a relationship, Progressive would be the most likely party to do it with”. A new entrant would require a contract with one of the major supermarkets. Without such a contract, it is unlikely a firm could realistically consider large-scale entry into the market due to the sunk cost risk involved in purchasing a supply of crates, at least 600,000, at a cost of $5-6 million, which is the amount required to fully supply Progressive or Foodstuffs.

174. Both FCC and the Applicant informed the Commission of recent innovations in crate technology. FCC stated it is trialling a crate that has a dual position for the handles so the crate can be used for different volumes. The nesting of the crates allows for closer stacking so that 300 empty crates may be stacked on a pallet rather than 100 of the single volume crates. While this is a change in crate technology, the Commission considers it to be of an incremental nature and not sufficient to create a means of entry for a new participant, which would enable it to mitigate the sunk cost risk associated with new entry.

175. CHEP submitted that the introduction of chip technology to the returnable crate supply chain was a future innovation that could provide a new entrant with a means of gaining a competitive advantage over existing crate hire firms. Chips would allow a crate hire company to maintain better control over crate supplies and prevent loss. However, Vivienne Power, General Manger of Weck, did not consider it likely that the technology would be introduced within a two year period in New Zealand.[39]

176. The Commission notes that the two examples of large scale new entry, Graeme Weck and CHEP, relied on particular market conditions. In both those examples, a supermarket facilitated entry, and at the time of entry, there were unique conditions in the market. There does not appear to be the same opportunity in the present market that previous entrants took advantage of when entering the market and the Commission does not consider that these types of conditions are likely to be present in the market within a two year period.

177. In addition, without a contract with a supermarket, a new entrant faces the risk of investing in a sunk cost (a supply of crates) and the possibility of its key customer withdrawing its support. As discussed earlier in this section, the Commission is of the view that a supermarket is unlikely to commit itself to such a contract. For these reasons, the Commission considers that large-scale entry to the market is unlikely.

Timeliness of Entry

178. The Commission believes if entry is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible

[39] Meeting with Commission staff, 5 March 2003

within a reasonably short timeframe from the point at which market power is first exercised.

179. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

180. On the basis of interviews with the crate hire companies and growers, the Commission considers a crate hire company of sufficient scope to compete with incumbent firms could be established within 12 to 18 months. Essential requirements are a sufficient supply of crates, distribution/washing centres and an alliance with a major supermarket.

181. The sole plastic crate manufacturer in New Zealand, Viscount, supplied the Commission with details of its crate production capacity. According to Viscount it could produce [ ] and [ ] Viscount also indicated it could source crate supplies from Europe further reducing the [ ] period needed to supply a million crates.

182. Based on this evidence the Commission is of the opinion that a firm seeking to enter the reusable crate hire market could do so within two years, providing it secured the support of a major supermarket.

Conclusion on Constraint from Potential Entry

183. The Commission concludes that barriers to entry in the reusable crate hire market are sufficient to prevent new entry, if the entrant cannot enter into a contract with a major supermarket. While a supermarket could support a new entrant of sufficient extent and within the required timeframe, the Commission, on the evidence before it, does not consider that it is likely a supermarket will take such action in response to a hypothetical crate hire price increase of 5%. More importantly, even if a supermarket were able to constrain prices, it is unlikely independent retailers would benefit from the supermarkets' ability to constrain prices or the constraint of any potential entry.

Barriers to Expansion

<u>FCC</u>

184. CHEP and Weck argue that FCC will provide a constraint on any efforts by CHEP/ Weck to raise the price of crate hire post acquisition. Weck submitted that FCC's connection with T&G means FCC's commercial incentives will be different from those of the merged entity. [ ]

185. In interviews with T&G and FCC, John Hambling, Director of T&G, stated that FCC is run as a stand alone operation and is expected to generate a profit.[40] Hans Wouter,

[40] Commission file note, FCC/ T&G, 10 March 2003

General Manager of FCC stated: "we will and we have gone head to head with Weck and CHEP on pricing and we will continue to do so."[41] FCC advised the Commission that [

]. However John Hambling stated: [

][42]

186. Progressive has stated it would consider using FCC crates in the event the merged entity increased prices, even though Progressive produce would be going through T&G. While it does appear FCC is willing to provide crates to Progressive without requiring Progressive produce to pass through T&G the likely motivator for Progressive to use FCC's crates would be a desire by Progressive to use T&G as its wholesaler in preference to Freshmax.

187. If FCC poses a realistic crate hire option, Progressive could threaten the merged CHEP/Weck entity by insisting a percentage of its growers use FCC crates in response to a crate hire price increase. FCC believes it would take a price increase of around [ ] before Progressive would consider shifting to FCC. Progressive stated: "Going to FCC crates has always been an option for Progressive."[43]

188. One of the potential problems with FCC servicing a portion of Progressive growers is the question of spare capacity. [ ] [

]

189. While it is possible Progressive could use FCC crates as a credible threat to constrain Weck, given FCC's willingness to service a percentage of Progressive's demand, Stuart Johnston stated: [

][45]

190. CRA in its submission stated a switch of [ ] by Progressive would make a 5% price increase unprofitable for the merged entity. It does appear FCC has sufficient capacity to service [ ] of Progressive's crate demand. A threat by Progressive to switch [ ] of its crate usage to FCC would act as a credible threat to constrain the merged entity. Progressive may not consider this a best case option but given FCC's willingness to supply Progressive, Progressive could credibly threaten to switch from the merged entity.

191. While FCC could service a portion of Progressive's crate demand, the incentive for FCC to purchase crate capacity sufficient to fully service Progressive has to be weighed against the sunk cost it would incur in purchasing additional crates. In making a decision to expand capacity, FCC would take account of the price that it would expect to prevail post-expansion. A significant increase in the supply of crates is likely to result in

[41] Ibid
[42] Ibid
[43] Commission file note, Progressive, 4 March 2003
[45] Commission file note, Progressive, 4 March 2003

a price war or significantly lower prices, as competitor(s) react to the increase in supply by lowering prices.

192. As the investment in crates is sunk, unless they can be utilised elsewhere, price could potentially drop towards the variable cost of supplying crates. FCC, aware of the impact of an increased supply of crates, would have difficulty recouping a return in a suitable payback period. [ ]

193. The Commission considers that FCC for incremental crate volumes, in the order of [ ] is able to provide a constraint on the CHEP/ Weck entity post acquisition. However, the extent to which FCC will expand in response to an increase in price by the merged entity will depend on factors such as buyer power and whether or not the two firms compete with each other sufficiently to restrict prices to competitive levels. Buyer power is discussed below, but the lack of countervailing power on the part of growers and independent retailers may make it more difficult for them to take advantage of FCC's ability to expand.

Conclusion on Barriers to Expansion

194. The Commission considers it likely FCC is able to expand at an incremental level, [ ], but would face high barriers to a level of expansion greater than [ ] of its crate supply.

OTHER COMPETITION FACTORS

Constraint from Buyers or Suppliers

195. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

196. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission therefore considers whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

Constraint from Cardboard Box Suppliers

197. The Commission has considered the degree of constraint that cardboard box manufacturers pose on crate hire companies. For the reasons previously discussed in the Market Definition section, and in light of the comments of cardboard box manufacturers that they do not consider that they pose a significant constraint on crate hire companies, the Commission is of the view that while cardboard boxes provide a degree of constraint on crate hire companies, it is unlikely to be sufficient to constrain the merged entity.

Constraint from Growers

198. The Applicant contends that growers would provide a constraint on the merged entity through their ability to switch to alternative forms of container packaging. As discussed above, growers of fresh produce are themselves constrained in their choice of packaging and therefore have insufficient ability to pose a realistic threat to the crate companies.

199. [ ], a large grower and [ ], advised the Commission that post acquisition he would have little ability to constrain the merged entity in relation to crate hire prices. He advised that since the merger between Progressive and Woolworths, Weck had effectively increased the price he pays for crate hire. [ ] suggested that if Weck were able to increase this price pre merger, then it would have greater ability to do so post merger, with CHEP removed from the market. [ ] doubted that growers would band together in sufficient numbers to be able to pose much of a constraint on the merged entity.

200. In interviews with Commission staff, Vegfed noted it has 2700 growers as members. The number of growers increases the difficulty of successfully establishing a grower consortium. [ ] view was supported by other growers the Commission interviewed during the course of its investigation.

201. The Commission notes that it might be possible for some growers, such as those who belong to the MG Marketing co-operative, to join together to bring pressure to bear on the crate company, in the event of an increase in the price of crate hire. However, on the whole, the Commission is persuaded on the evidence that growers are too fragmented to be able to exert sufficient pressure on the merged entity so as to constrain prices.

Constraint from Wholesalers

202. The Applicant states that in New Zealand there are around 28 wholesalers of fresh produce, with MG, CSI and T&G accounting for approximately [ ] of the volume of produce sold through the market system. In addition, the Applicant submits that these particular wholesalers have "considerable buying strength and significant influence on the type of container packaging growers are required to use". However, the Commission notes that T&G, which has an estimated [ ] of the produce wholesale market, is vertically integrated downstream through its subsidiary, FCC, and therefore is likely to advocate the use of FCC crates in any event. With the combined market share of MG and CSI being approximately [ ], and with the remainder of the wholesale market being fragmented, the Commission considers that wholesalers have insufficient countervailing power to act as a constraint on the merged entity.

Constraint from Retailers

203. In respect of the constraint offered by retailers, the Applicant contends that if the merged entity were to increase prices, growers would attempt to recover those increases in their produce prices. The Applicant suggests that retailers, and in turn wholesalers, would apply considerable pressure on growers to constrain produce prices.

Supermarkets

204. CHEP argues that the close relationships Progressive and Foodstuffs have with Weck and FCC respectively, act as a further incentive for crate companies to keep the cost of crate hireage low.

205. As evidence of the crate companies' reliance on, and thus responsiveness to, the demands of the major supermarkets, Weck submitted to the Commission that the existing relationship with Progressive accounts for [ ] of Weck's business.

206. As noted in the barriers to entry section, the imposition of a 5% increase in the price of crate hire, assuming growers pass the increase through the supply chain, would see an increase in the total cost of Progressive's produce of around [ ] per annum. Stuart Johnston from Progressive advised the Commission that in the event of such an increase, "we would have words with them {CHEP/Weck} but whether that is enough to really stop them from doing it is questionable".

207. A further issue is: at what level of increase in crate hire charges would supermarkets be motivated, under pressure from grower suppliers, to exert such pressure on crate companies that an increase was limited or cancelled? The Commission understands that the wholesale prices of fresh produce are determined by demand and supply on a day by day basis and any impact of increased crate prices will not be felt until increased crate prices are factored into the decisions of growers about supply.

208. Peter Silcock, Chief Executive of Vegfed, in discussing price increases as a result of increased crate hire prices stated, "Supermarkets don't pay, the growers do".[46] Therefore the impact of increased crate prices is not likely to feed into wholesale prices of produce until some time after the crate hire prices increases are announced. This factor may slow or dampen any reaction of the supermarkets to increased crate prices. Given Stuart Johnston's comments noted previously: "at 5% we would have words with them but whether that is enough to stop them from doing it is questionable…", it would appear an increase somewhat in excess of 5%, would be required before supermarkets would act.

209. In addition, the Commission doubts whether Progressive would consider [ ] sufficient for it to either support expansion by FCC or new entry, particularly given the efficiencies it claims to gain from utilising only one crate company.

210. The Applicant submits that supermarkets hold significant countervailing power over crate companies, through their desire to keep produce costs as low as possible. The Applicant argues that, as there is no formal contract between Progressive and Weck, Progressive could respond quickly to any increase in the price of crate hire by approaching FCC to expand or assisting a new entrant. As discussed above, FCC's ability to expand its capacity may be dependent on it securing a medium to long-term arrangement with Progressive.

211. Furthermore, it is uncertain whether new entry is likely. Although the Progressive chain has supported new entry in the past, it did so to obtain the benefits of an improvement in technology; a move from wooden to plastic crates. Recently, FCC has trailed the

[46] See Vegfed File Note, 6 Dec 2002

introduction of a novel dual volume, 28 litre crate to the market, however the Commission considers this change in technology to be insufficient either to mitigate the risk of new entry, or justify considerable expansion by existing players. The Commission reached this conclusion on the basis that there is little evidence of significant cost reductions associated with the crate.

212. In respect of the potential constraint posed by independent retailers, Stuart Johnston advised the Commission that, in his opinion, if the combined entity were to increase prices, "the independent retailers would be hit first but Progressive would get hit at some point", which suggests that Progressive would have a degree of countervailing power.

<u>Independent Retailers</u>

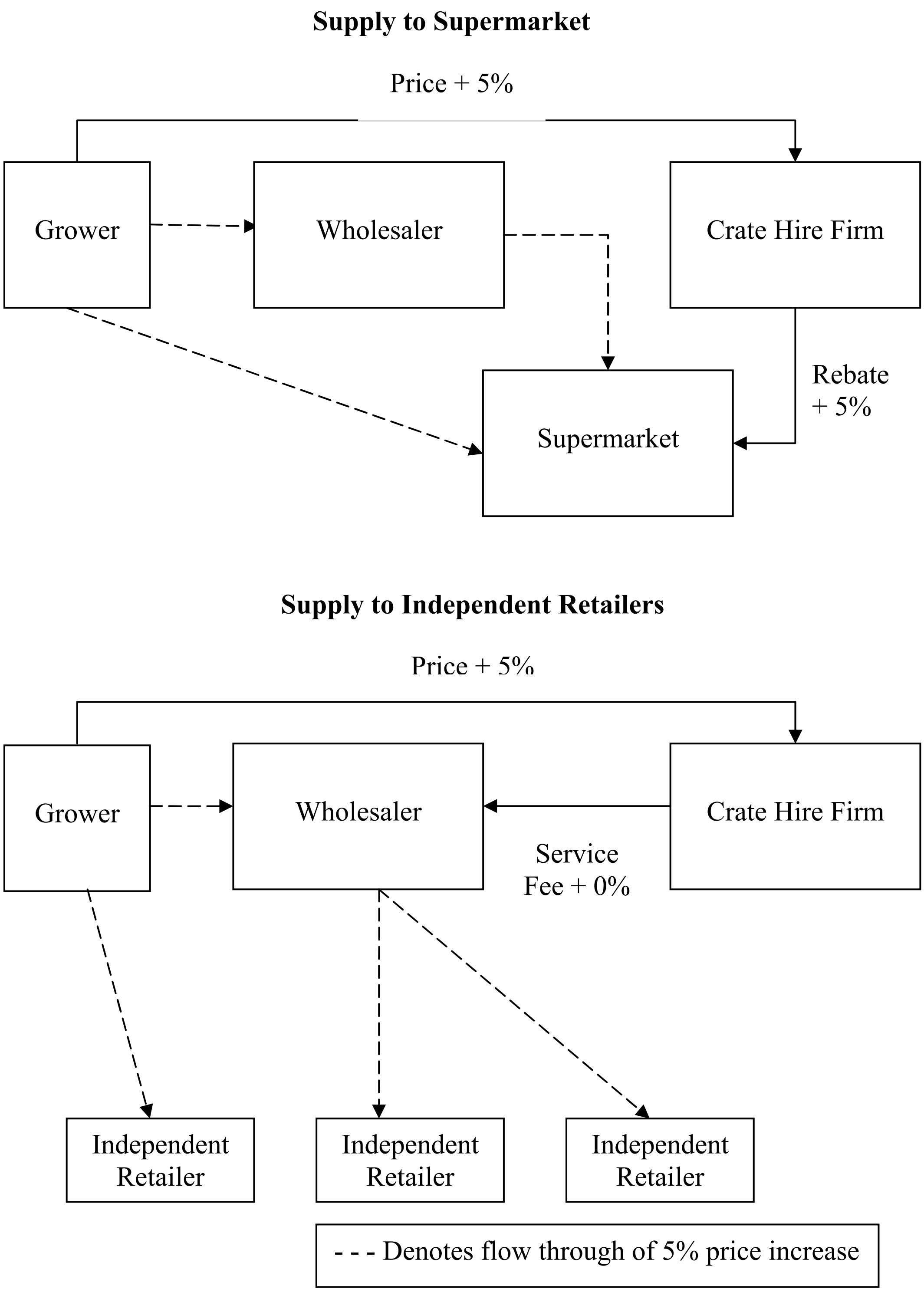
213. The Commission also canvassed the issue of countervailing power with independent retailers. Green Rebel is a large independent retail chain in Auckland with branches in New Lynn, Mt Eden, Birkenhead, and Browns Bay. Green Rebel advised the Commission that it did not believe that, on the whole, independent retailers had sufficient volume individually to bring any great pressure to bear on the merged entity. However, Green Rebel did advise of a recent situation in Wellington where independent retailers boycotted FCC over FCC's decision to move its Wellington operation to Palmerston North.

214. According to Green Rebel the Wellington independent retailers refused to buy their produce through T&G, which in turn meant that they did not have to use FCC crates. Green Rebel said that the strategy was effective, as FCC eventually resumed its Wellington operation. When asked whether it thought the strategy would work in other places, Green Rebel suggested that the Wellington situation was atypical, as independent retailers were proportionately fewer, and similar in size, and therefore more able to combine as a united group, as they were less likely to be competing so much with each other. Green Rebel doubted that Auckland independents would group together to exert pressure on a CHEP/Weck entity, as the independent retailers often compete directly with one another and range in size from small to large.

215. Green Rebel was of the view that independent retailers would therefore be virtually powerless to constrain the merged entity in relation to prices, and that as the supermarkets had an amount of countervailing power, independent retailers would be hit with crate hire increases passed through the supply chain.

216. The Applicant argues that it is unable to discriminate between growers that supply supermarkets and growers that supply independent retailers. The potential ability of the merged entity to price discriminate according to the type of retailer is illustrated in Figure 3 below. The Commission notes that crate companies already charge significantly different prices to growers, while the price differences may represent cost differences, it may also indicate the ability of crate companies to successfully discriminate between growers.

Figure 3: Ability of CHEP/Weck to Price Discriminate



217. In the Commission's view, the merged entity would be able to neutralise any countervailing power that a supermarket has by increasing its rebate payment to a supermarket by the same amount (5%) of the price increases it imposes on the grower for crate hire, thereby offsetting any increase to the cost of produce which may be passed

through the supply chain by growers and wholesalers. [ ]

218. In the case of independent retailers, however, the merged entity would be aware of the relative fragmentation of retailers and also wholesalers. [ ] Accordingly, independent retailers would have little ability to mitigate the 5% increase, and the merged entity would be successful in price discriminating against growers supplying independent retailers.

Conclusions –Constraints from Buyers or Suppliers

219. On balance, the Commission is of the view that while supermarkets may have some degree of countervailing power, it would appear that any countervailing power that the growers, wholesalers and independent retailers might have is likely to be insufficient to constrain the merged entity.

Conclusion on Unilateral Market Power

220. The Commission considers that CHEP's presence in the market acts as a constraint on FCC and Weck.

221. The Commission considers that new entry into the market is unlikely without a contract with a supermarket. The Commission considers that on the basis of probabilities it is unlikely a supermarket will enter into a contract with a new entrant in response to a 5% increase in the price of crate hire. Therefore the Commission considers new entry unlikely.

222. The Commission considers FCC will not provide sufficient constraint to prevent the merged entity increasing crate hire prices by 5%.

223. The Commission is of the view that the countervailing power of supermarkets may be sufficient to constrain the behaviour of the merged entity and FCC post acquisition. However, the Commission does not consider independent growers, wholesalers or independent retailers have sufficient countervailing power to prevent the merged entity from increasing crate hire prices.

224. The Commission considers that on the basis of probabilities the scope for the exercise of unilateral market power would be enhanced by the acquisition.

Scope for the Exercise of Coordinated Market Power

Introduction

225. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to

behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

226. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

227. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

228. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

229. The structural and behavioural factors that are usually considered conducive to collusion are set out in the left-hand column in Table 4. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the reusable crate hire market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

TABLE 4: Testing the Potential for 'Collusion' in the Hire of Reusable Plastic Crate Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes—Post acquisition only two participants in market.
Undifferentiated product	Little differentiation.
New entry slow	Yes—Although entry could occur inside two years, it is unlikely to occur without supermarket support.
Lack of fringe competitors	Yes.
Price inelastic demand curve	Yes.
Industry's poor competition record	No.
Presence of excess capacity	Yes-CHEP's crate supply.

Factors conducive to collusion	Presence of factors in the market
Presence of industry associations/fora	No.

230. Table 4 suggests that the market for the hire of reusable plastic crates is likely to be susceptible to collusion, post acquisition. The assessment of the relevant structural and behavioural conditions in the reusable crate hire market suggests that because entry without the support of a supermarket is unlikely and cardboard exercises little constraint on crates, the conditions in the market are conducive to collusion by the remaining crate hire firms post acquisition.

Discipline

231. For coordination to be successful, deviations of individual firms from the collusive behaviour have to be discouraged by being detected swiftly and punished by the other firms.

232. The structural and behavioural factors that are usually considered to be conducive to 'discipline' in co-ordinated markets are set out in the left-hand column in Table 5. Again, the significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the reusable crate hire market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'discipline; a high proportion of 'no' responses the reverse.

TABLE 5
Testing the Potential for "Discipline" in the Reusable Crate Hire Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes.
Sales small and frequent	No—large growers use high volumes of crates annually.
Presence of vertical integration	Yes—but the T&G/FCC relationship has no effect on price transparency.
Demand slow growing	Yes.
Firms have similar costs	Yes.
Price transparency	No—discounting below list price is prevalent in industry.

233. On face value, the assessment of the relevant structural and behavioural conditions in the crate hire market in Table 5 suggests that the market is one where discipline is may not easily be maintained, should a collusive understanding or arrangement be attained. The vertical integration between FCC and T&G does not undermine the likelihood of collusion in this case as the ability of the integrated firms to conceal prices charged to downstream customers, in this case growers, does not exist.

234. The lack of price transparency in the market makes monitoring difficult for firms engaging in collusive agreements. Volume-based rebates are prevalent in the reusable crate hire market and would be difficult for colluding firms to monitor. Also, the size of large grower sales provides an incentive for crate hire firms to break from collusive agreements to gain increases in crate utilisation.

235. However the current vertical split in the market, with FCC largely supplying Foodstuffs and independents (FCC supplies independents through T&G), and Weck largely supplying Progressive and independents, may enable the firms easily to reach a tacit understanding for market sharing. It would be possible for the two remaining competitors to divide the supply of crates to independents. FCC could supply T&G and leave the remaining portion of the market for the merged entity. Any deviation from the market sharing arrangement would be readily apparent to the rival and allow for effective discipline.

236. CHEP, as the third competitor in the market, currently provides growers and independent retailers with the means to counter any tacit market sharing between FCC and Weck. Post acquisition, in the event that the two remaining crate hire firms raised crate hire prices by 5%, growers would have little recourse but to absorb the increase or pass the cost through the supply chain.

Conclusions – Co-ordinated Market Power

237. The Commission is of the view that the lack of price transparency and large volume sales could undermine attempts by the crate firms, post acquisition, to successfully engage in coordinated behaviour. However, the ability to set clearly the boundaries for market sharing offsets the lack of price transparency. Therefore, the Commission considers the acquisition is likely to enhance the scope for co-ordinated market power.

Conclusions – Existing Competition

238. The Commission considers that the scope for the exercise of unilateral market power would be enhanced by the acquisition.

239. The Commission considers that the scope for the exercise of coordinated market power would be enhanced by the acquisition.

Elimination of a Vigorous and Effective Competitor

240. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

241. The majority of industry participants spoken with believe CHEP is a small player in the hire of reusable plastic crates. Progressive has stated it does not consider CHEP a credible option for crate hire. While CHEP does have a small market share and is

unlikely to have the capacity to fully service Progressive or Foodstuffs, industry participants have indicated CHEP acts as a useful constraint on Weck and FCC, particularly in relation to their supply of crates to growers supplying independent retailers.

242. This is particularly true for growers and independent retailers who may bear the brunt of price increases post acquisition. As noted in the Existing Competition and Barriers to Expansion sections, without CHEP as an alternative in the market, it is possible FCC and CHEP/Weck via tacit collusion could increase prices to growers. By increasing a rebate payment to supermarkets, the crate hire firms could remove the incentive for supermarkets to exercise their countervailing power as the increased input prices to the cost of the supermarkets produce would be offset by the rebate.

243. This strategy would leave independent retailers with higher priced produce than the supermarkets. [ ] in New Zealand noted it could, [ ] if Weck decided to lower service levels or raise prices. CHEP's ability to act as a third competitor in the market provides an important degree of constraint on the other two crate companies. This conclusion is supported by FCC's statement that, "we {FCC} will and we have gone head to head with Weck and CHEP on pricing and will continue to do so."[47] Cleary both potential customers and existing competitors regard CHEP as a relevant competitor in the market.

[47] Commission file note, FCC/ T&G, 10 March 2003

OVERALL CONCLUSION

244. The Commission has considered the probable nature and extent of competition that would exist in the market for reusable crate hire for produce. The Commission considers that the appropriate counterfactual for comparison is the status quo.

245. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would result in the merged entity obtaining a market share which falls outside the Commission's safe harbour guidelines.

246. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

Constraint from Existing Competition;

- The Commission considers that despite CHEP's low market share in terms of the percentage of the market it supplies, CHEP's excess capacity provides some degree of constraint on existing market participants. The level of constraint provided by CHEP for growers supplying Progressive and Foodstuffs (Auckland) is limited. However, for growers supplying independent retailers and Foodstuffs (South Island) and Foodstuffs (Wellington), CHEP is a significant competitive alternative in the market.

Constraint from Potential Competition from Entry;

- The Commission concludes that barriers to entry in the reusable crate hire market are sufficient to prevent new entry, if the entrant cannot enter into a contract with a major supermarket. While a supermarket could support a new entrant of sufficient extent and within the required timeframe, the Commission, on the evidence before it, does not consider that it is likely a supermarket will take such action in response to a hypothetical crate hire price increase of 5%. More importantly, even if a supermarket were able to constrain prices, it is unlikely independent retailers would benefit from the supermarkets' ability to constrain prices or the constraint of any potential entry.

Constraint from Barriers to Expansion

- The Commission considers it likely FCC is able to expand at an incremental level, [ ], but would face high barriers to a level of expansion greater than [ ] of its crate supply.

Constraint from Other Competition Factors

- On balance, the Commission is of the view that while supermarkets may have some degree of countervailing power, it would appear that any countervailing power that the growers, wholesalers and independent retailers might have, is likely to be insufficient to constrain the merged entity.

Potential for Coordinated Market Power

- The Commission is of the view that the lack of price transparency and large volume sales would undermine attempts by the crate firms, post acquisition, to successfully engage in coordinated behaviour. However, the ability to set clearly the boundaries for market sharing offsets the lack of price transparency. Therefore, the Commission considers the acquisition is likely to enhance the scope for co-ordinated market power.

247. The Commission is therefore not satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for the hire of reusable plastic crates for the transport and storage of fresh New Zealand produce.

DETERMINATION ON NOTICE OF CLEARANCE

248. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to decline clearance for the acquisition by Brambles New Zealand Ltd of the business and assets of GE Capital Returnable Packaging Systems Ltd.

Dated this 21st day of March 2003

MJ Belgrave
Chair