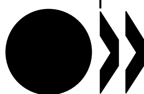

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development 02-Nov-2016

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WP3/WD(2016)44
Unclassified

Working Party No. 3 on Co-operation and Enforcement

GEOGRAPHIC MARKET DEFINITION

-- Note by New Zealand --

28-29 November 2016

This document reproduces a written contribution from New Zealand submitted for Item 3 of the 124th meeting of the OECD Working Party No. 3 on Co-operation and Enforcement on 28-29 November 2016.

More documents related to this discussion can be found at ww.oecd.org/daf/competition/geographic-market-definition.htm

Please contact Ms. Despina Pachnou if you have any questions regarding this document [phone number: +33 1 45 24 95 25 -- E-mail address: despina.pachnou@oecd.org].

JT03404242

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-- NEW ZEALAND --

1. Market definition

1. The Commerce Act 1986 (the Act) contains several sections which prohibit restrictive trade practices "in a market". The following sections set out the approach to a "market in New Zealand".

- Section 3(1A) of the Commerce Act 1986 states: "Every reference in this Act, except the reference in section 36A(2)(b) and (c), to the term market is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."

- Section 4 of the Act also states: "This Act extends to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand."

2. In New Zealand, geographic markets are defined with reference to both demand- and supply-side substitution.

- Demand-side substitution analysis examines the economic viability of consumers purchasing from one geographic area rather than another. Regions are demand-side substitutes if enough buyers would switch to the substitute areas such that a SSNIP would be unprofitable. In a market where there is price discrimination, switching by one set of buyers to other areas will not necessarily discipline the price to the remaining buyers.[1]

- Close supply-side substitutes are regions in which suppliers can easily move supply when they are given a profit incentive to do so. To be a close supply side-substitute, suppliers must be able to profitably supply in the substitute region with little change to their production facilities and little or no additional investment.[2]

3. This approach to market definition was confirmed by the New Zealand courts in the Air New Zealand case. In this case, the Court referred to a judgment from Australia which clearly explains the concept of a market:

> "Within the bounds of a market there is substitution — substitution between one product and another, and between one source of supply and another, in response to changing prices... Let us suppose that the price of one supplier goes up. Then on the demand side buyers may switch their patronage from this firm's product to another, or from this geographic source of supply to another.

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1 Pact Group Pty Limited and Viscount Plastics (NZ) Limited [2012] NZCC 11 at [50]. http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/726

2 Ibid, at [54].

> As well, on the supply side, sellers can adjust their production plans, substituting one product for another in their output mix, or substituting one geographic source of supply for another. Whether such substitution is feasible or likely depends ultimately on customer attitudes, technology, distance, and cost and price incentives."[3]

4. In the Air New Zealand judgment, the Court went on to make the point that while substitution is a prominent feature of market definition, it is not completely determinative:

> "Substitutability is not the sine qua non of market definition. It is of great importance but it is not of itself determinative. Thus, a reference to market includes the substitutable services, but the presence of substitutable services is not the sole driver of market definition. We do not think it correct that markets must always be limited to where say, in the case of a service, the substitutable services are geographically located. Without wishing to be definitive, while we see the heart of a market in economic terms as being the actual and prospective transactions between sellers and buyers, the broader ambit of a "market" looks to the rivalry between sellers for those who will buy their products, and encompasses the factors that directly shape and constrain that rivalry, as a matter of fact and commercial common sense."[4]

5. New Zealand courts have reiterated that market definition is a tool to aid in competition analysis, rather than an end in itself. This approach was adopted in the Commerce Commission's Mergers and Acquisitions Guidelines.[5] In particular, the Commission recognises that relevant markets need not always be defined precisely. Markets are defined in the way that best isolates the key competition issues that arise from the merger or anti-competitive conduct.

6. The Commission's general approach to defining the geographic dimension of the market involves using the hypothetical monopolist test. The nature of the market where the proposed merger or acquisition will occur is examined to determine the extent to which the location of suppliers and consumers is relevant. Where demand-side substitution is the critical factor in defining geographic markets, the market may be defined based on supplier location. Conversely, in cases where supply-side substitution is important, the market may be defined based on the location of customers. However, in some cases both demand and supply side substitution may be relevant. In markets where the supplier has market power and is able to prevent arbitrage between groups of customers price discrimination markets may be relevant.

7. When the geographic market dimension is defined based on supplier location, this involves assessing the region in which a hypothetical monopolist would profitably impose a SSNIP from at least one location. The question asked is whether customers would switch sufficient purchases from the hypothetical sole supplier in a region to suppliers located outside the region to make the SSNIP unprofitable, holding constant the terms of sale for all products outside of the region. Various factors are taken into consideration, such as whether customers have previously switched purchases between different geographic locations in response to relative changes in prices, and the views of buyers and suppliers regarding the likelihood of switching between different geographic sources. The cost and difficulty of transporting the product is also examined, or the cost and difficulty for a customer to travel to a supplier's location, in relation to the price of the product.

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[3] *Re Queensland Co-operative Milling Association Ltd* (1976) 8 ALR 481 (TPT) at 517 as cited in *Commerce Commission v Air New Zealand Ltd* [2011] HC Auckland at [117]. http://www.comcom.govt.nz/business-competition/enforcement-response-register-commerce/selected-judgments/competition-selected-judgments/

[4] Commerce Commission v Air New Zealand Ltd [2011] HC Auckland at [122]-[124].

[5] Commerce Commission, Mergers and Acquisitions Guidelines, July 2013. http://www.comcom.govt.nz/business-competition/guidelines-2/mergers-and-acquisitions-guidelines/

8. This approach has been used in decisions involving the mergers of supermarkets, where the geographic markets were defined by a 5 kilometre radius around the supermarkets in question. This distance was arrived at by assessing how far consumers would be prepared to travel in order to avoid paying higher prices, in the event that a hypothetical single supermarket in one area raised its prices by 5%, taking into account travel time and cost.[6] The Commission recognised that this approach was just a starting point for defining the geographic scope of the market, and could vary between regions. The willingness of customers to travel to avoid a SSNIP may be affected by such matters as the state of the roads, traffic flows and the level of motor vehicle ownership. The population density in different parts of the country can vary, and it may be that there are relatively few customers who live between the supermarkets. In addition, supermarkets are differentiated, so that some consumers may, for example, consider a "full service" supermarket not to be an adequate alternative to a "discount" supermarket, notwithstanding that they are within 5 km of each other.[7]

9. When the geographic market is defined on the basis of the location of customers, there is an assessment of the region from which a hypothetical monopolist could profitably impose a SSNIP on some buyers in that region, holding constant the terms of sale for all products sold to buyers outside of this region. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. This approach is often taken when a product is delivered directly to customers.

2. Defining a geographic market as wider than New Zealand

10. As mentioned above, the Act makes several references to a "market", as well as a "market in New Zealand". The most common approach in merger cases where consumers have the option to purchase goods or services from overseas providers has been to define the market as nationwide, then consider how imports could constrain the market at the competition analysis stage. While the Commission takes import substitution into account, market boundaries are not automatically extended to include all sources of import competition. The ways in which imports are considered as constraining a merged party are outlined below.

11. While the Commission has seldom had to define a wider market than New Zealand, one case in which the issue was examined was Commerce Commission v Air New Zealand. In this case, the meaning of the words "market in NZ" was analysed, along with how this meaning might limit the application of the Act.

3. Air New Zealand

12. The statutory definition of a market in New Zealand was interpreted by the High Court in the Air New Zealand case.[8] In 2008 the Commerce Commission commenced proceedings against 13 international airlines and eight airline executives, alleging the airlines colluded to raise the price of freighting cargo by imposing fuel surcharges on cargo shipments into and out of New Zealand. The conduct was alleged to have occurred over a period of more than seven years.[9]

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[6] Foodstuffs (Auckland) Ltd, Foodstuffs (Wellington) Co-operative Society Ltd, Foodstuffs South Island Ltd and (separately) Woolworths Ltd and The Warehouse Group Ltd (Commerce Commission Decisions 606 & 607, 8 June 2007) at [140]. http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/601

[7] Ibid, at [141].

[8] Above n 4.

[9] Commerce Commission Media Release, "Commerce Commission gets green light to proceed with air cargo price-fixing case" (26 August 2011). http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2011/commerce-commission-gets-green-light-to-proceed-with-air-cargo-price-fixing-case-2

13. The Court was asked to decide whether there was a "market in New Zealand" for the inbound air cargo services that the Commission alleged were the subject of price-fixing by the defending airlines. Jurisdiction regarding outbound air cargo was not disputed. The airlines argued that for cargo inbound to New Zealand the competition between the airlines occurred only at overseas ports of origin and not in New Zealand, and that for these reasons the Commission's inbound price-fixing claims were outside the reach of the Act.

14. The Court determined that inbound air cargo services were supplied in a market in New Zealand, and that the Court had jurisdiction to hear the Commission's case in full. The Court held that it was sufficient that part of the market is situated in New Zealand, noting that it "[saw] the fact that part of the service takes place in New Zealand as an important facet of the reality that part of the market is in New Zealand".[10] In this case, the arrival and handling of cargo in New Zealand, and the demand for cargo shipments from New Zealand importers, were key factors in the Court's finding that a market for inbound cargo services existed in New Zealand.

15. The Court rejected the airlines' argument that competition between the airlines stopped at the moment the cargo contracts were entered into at ports of origin, and found that such a narrow analysis "does not seem ... in accord with the facts and common sense".[11]

16. The issues specifically addressed by the Court were as follows:

- Was the Commission required to prove a market in New Zealand?
- Did the airlines supply inbound air cargo services in competition with each other in New Zealand?
- Was there a “market in New Zealand” for inbound air cargo services?
- The interpretation of section 4 of the Act.[12]

3.1 Requirement for the Commission to prove a market in New Zealand

17. The Court looked at what the Commission was required to prove in terms of its claims under the substantial lessening of competition and price fixing provisions of the Act. The question was whether the Commission needed to establish that the parties to the agreement were in competition in a market in New Zealand, or whether the per se nature of the breach meant it was enough to prove they were competing with each other in New Zealand. The conclusion was that it was necessary for the Commission to prove that each of the pleaded services subject to the alleged price fixing arrangement were supplied by the defendants in competition with each other in a market in New Zealand.[13]

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10 Above n 4 at [194].

11 Ibid, at [193].

12 Ibid, at [5].

13 Ibid, at [273].

18. In reaching this conclusion, the Court considered the purpose of sections 27[14] and 30[15] of the Commerce Act, stating:

> "It would be going beyond the purposes of s 27 to deem a market to be a market in New Zealand that is in fact overseas. The goal of s 30 appears to be restricted to obviating the need to prove a substantial lessening of competition in a market, not to extending the Act's territorial reach."[16]

19. The Court went on to say, "To interpret the Act as governing competition in markets wholly outside of New Zealand would be to confer on it extraterritorial jurisdiction."[17] This interpretation was found to be consistent with the purpose of the Act.[18] The Act's purpose is "to promote competition in markets for the long-term benefit of consumers within New Zealand."[19] The Court then stated:

> "However, the s 3(1 A) requirement that a reference to a market is a reference to a market in New Zealand remains, and if there is no market in New Zealand there is nothing on which the deemed substantial lessening of competition can bite."[20]

20. The Court commented that the Commission would not necessarily need to delineate the market in every price-fixing case, but would need to go far enough to establish a market in New Zealand.[21] After examining the relevant case law, the Court stated:

> "The general tenor of these authorities is inconsistent with the submission of the airlines that the legislature intended to couple the requirement of proof of competition to that of proof of a market. In the ordinary run of cases, where there is no issue about the territoriality of the market, it will not be necessary to plead and prove a market. This is consistent with the per se nature of s 30. If the competition is in New Zealand it will likely be assumed in the absence of evidence to the contrary that the market is in New Zealand. However, in none of these authorities is it suggested that there is no need for there to be a market in New Zealand."[22]

3.2 Airlines' supply of inbound air cargo services in competition with each other in New Zealand

21. The defendants admitted that they were in competition to supply inbound air cargo services, but argued that this was not in a market in New Zealand since the relevant exchange occurred at the point of origin. The distinction was made between the location of supply and the performance of the services.

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[14] Section 27 of the Commerce Act 1986 prohibits contracts, arrangements, or understandings which substantially lessen competition.

[15] Section 30 of the Commerce Act 1986 states that contracts, etc., with respect to price fixing are deemed to substantially lessen completion.

[16] Above n 4 at [68].

[17] Ibid, at [72].

[18] Ibid, at [75].

[19] Commerce Act 1986, s 1A

[20] Above n 4 at [74].

[21] Ibid, at [85].

[22] Ibid, at [95].

22. The Court stated:

> "When an airline flies air cargo into New Zealand it is providing a service being a facility to transport cargo. The provision of that service does not stop at the point of departure from the place of origin. There can be active ongoing work during the flight such as caring for livestock. This can continue into the New Zealand 200 mile zone and throughout the flight until the aircraft carrying the cargo has landed. The cargo is then unloaded in the New Zealand airport by the airline and its agent. There can be follow-up services provided by the airline if there have been any problems in the carriage and landing of the cargo."[23]

23. The Court then held that the activities undertaken by the airlines within a 200 mile zone of New Zealand constitute the supply of air cargo services in competition with each other in New Zealand.[24] It was noted:

> "A bystander observing the activities of two different aircraft in landing in New Zealand and unloading, if one was doing it better than the other, would perceive the better performer as achieving a competitive advantage. Those actions, relating to the transport of air cargo in New Zealand, would be seen as occurring between parties in competition with each other. If the bystander were an importer, or its destination freight forwarder, it is possible that what was observed could influence later decision making."[25]

3.2.1 "Market in New Zealand" for inbound air cargo services

24. The Court stated:

> "While there is no doubt that the supply of air cargo services extends into New Zealand as the aircraft enter the 200 mile zone, the argument of the airlines was that the geographical dimensions of the supply of air cargo services are not conterminous with the geographical dimensions of the market for those services. The market for air cargo services, they submitted, is located at origin."[26]

25. On this issue, the Court concluded that the market for inbound air cargo services was not confined to the point of origin but rather extended to, and so was at least in part in, New Zealand.[27] In reaching this conclusion, the Court looked at the purpose of market definition, stating:

> "In this case there has been particular emphasis on the geographic dimension, to ascertain whether the market is in New Zealand. But the geographic boundaries of a market will tend to follow the product and functional dimensions, rather than lead them. It is the product dimension in particular in terms of goods or services supplied or purchased, that is of particular interest and will tend to dictate the geographic boundaries of the market."[28]

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23 Ibid, at [102].

24 Ibid, at [105].

25 Ibid, at [103].

26 Ibid, at [111].

27 Ibid, at [211].

28 Ibid, at [128].

26. In considering the application of the SSNIP test, the Court stated:

> "We are satisfied that the hypothetical monopolist in considering the consequences of a SSNIP would look beyond the port of origin to where the price impact will affect the demand for its air cargo service. That place is where the ultimate person who pays for the goods resides, either the place of the exporter or the place of the importer. The focus will not be exclusively on the freight forwarder as the freight forwarder ultimately does not pay."[29]

27. The Court went on to find that the location of the market extended "… beyond the cargo door to the geographic location of the persons whose demands will drive the place and terms of the end contract of carriage."[30]

28. The Court stated:

> "Indeed, we see the fact that part of the service takes place in New Zealand as an important facet of the reality that part of the market is in New Zealand. Demand emanates from New Zealand because the service is the carriage by air of cargo to New Zealand. While the airlines contract with origin freight forwarders overseas, we have earlier observed that they compete in New Zealand for the goodwill that will lead ultimately to custom."[31]

29. On the issue of whether a market needs to be wholly or partly in New Zealand, the Court accepted the Commission's submission that there may well be markets in New Zealand for goods and services supplied overseas in worldwide markets. The Court went on to state, "We have no doubt that as a matter of fact markets are not limited by territorial borders and can extend across different countries."[32] The market for inbound cargo services was clearly not wholly in New Zealand, but the airlines argued that this was not sufficient for jurisdictional purposes, that market boundaries could not be drawn wider than New Zealand.[33]

30. It was noted that the wording of section 3(1A) had been changed from "within" to "in" New Zealand and that "… the word 'within' carries with it a greater sense of enclosure or containment than does the word 'in'."[34] However, the Court considered that the subsection was "ambiguous as to whether market must be wholly, or can be only partly, in New Zealand."[35] The Court then went on to state that the phrase "market in New Zealand" should be interpreted as including a market partly inside and partly outside New Zealand, since the words of section 3(3) contemplate the consideration of overseas competition.[36]

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[29] Ibid, at [180].

[30] Ibid, at [182].

[31] Ibid, at [194].

[32] Ibid, at [212].

[33] Ibid, at [213].

[34] Ibid, at [214].

[35] Ibid.

[36] Ibid, at [219].

31. The Court also considered the fact that section 36A of the Act makes specific provision for "trans-Tasman markets".[37] Section 36A(2) states:

> A person must not, for any of the purposes specified in subsection (3), take advantage of the person's substantial degree of power (if any)—
>
> (a) in a market; or
>
> (b) in a market in Australia; or
>
> (c) in a market in New Zealand and Australia.

32. On the section 36A issue, the Court stated:

> "Section 36A creates a supplementary jurisdiction. It arose out of the decision to remove the application of anti-dumping laws to trans-Tasman trade in goods as part of the Closer Economic Relations review in 1988[38]… We do not accept that the insertion of s 36A manifested a legislative intention not to regulate international or global markets unless expressly provided, and accordingly reject the airlines' submission that the Act does not extend to a market only in part in New Zealand with the exception only of a trans-Tasman market for the purposes of s 36A."

33. An approach that would limit the consideration of overseas conduct to those acts that occur in New Zealand was also looked at. On this issue, the Court stated:

34. "We conclude that a purposive interpretation of the Act does not require us to limit our considerations to New Zealand conduct. The presumption that Parliament did not intend to assert extraterritorial jurisdiction will apply but will be subject to s 4 which permits overseas conduct to be considered if it has an effect on the relevant NZ market. Therefore, we consider the words "in a market" are not on their plain meaning and in the context of the other provisions of the Act limited to markets wholly in NZ."[39]

35. In answering the question of whether there was a "market in New Zealand", the Court stated:

> "We conclude that a market does not have to be wholly in New Zealand. We are not required at this point to define the extent of the market that must be in New Zealand. We are satisfied on the facts before us that the market in New Zealand for air cargo services from an overseas country or region to New Zealand has a sufficient presence in New Zealand to constitute a "market in New Zealand" in terms of the Act."[40]

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[37] Ibid, at [220].

[38] *Gault on Commercial Law* at [CA36A.01] and [CA36A.03] and the Commerce Law Reform Bill 1989 (238-1) (explanatory note) as cited in above n 4, at [224].

[39] Above n 4 at [235].

[40] Ibid, at [241].

36. The Court also stated that there was a market in New Zealand for inbound air cargo services with the following constituents:

- importer and destination freight forwarder demand from New Zealand
- on occasions New Zealand importer decisions in relation to inbound air cargo
- inbound flights over New Zealand air space
- unloading in New Zealand
- follow-up on transport issues including lost or damaged air cargo
- economic effects of inbound services and their cost having an impact in New Zealand.[41]

3.3 The interpretation of section 4 of the Act

37. The Court held that the Act applies to the engaging in conduct outside New Zealand by any person resident or carrying on business in New Zealand where the conduct:

- would be prohibited by a substantive provision of the Act if it occurred in New Zealand
- "affects a market in New Zealand" by affecting competition in the market in New Zealand in respect of which that substantive provision is alleged to have been breached. [42]

4. Imports constraining a market

38. New Zealand is a small, open economy, and thus engages heavily in international trade. The geographical isolation of the country means that importing and exporting certain products can be logistically difficult, with high transport costs. Despite this, New Zealand continues to rely on imports, particularly from suppliers China, Australia and the USA.[43] Because of this reliance, imports often play an important role in competitive markets, and this is reflected in the competition analysis in various decisions in New Zealand. Imports often make up a large share of a market, and may sometimes have high supply elasticity.

39. The Commission does not generally define a market that is broader than NZ, but often considers imports as an important constraint in the market. One reason imports may not be defined as part of the geographic market is due to discontinuities in supply, in that not all suppliers from the origin countries are potential exporters. Some, for example, faced with the need to make a substantial investment in advertising and promotion, overcoming regulatory barriers and/or to establish distribution infrastructure in New Zealand, may see more profitable opportunities in places other than New Zealand.

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[41] Ibid, at [242].

[42] Ibid, at [273].

[43] These three countries accounted for 40.1% of merchandise imports in the year to 30 September 2014. The Treasury "New Zealand Economic and Financial Overview 2015" at 28. Data sourced from Statistics New Zealand. http://www.treasury.govt.nz/economy/overview/2015

40. Imports may also be differentiated or niche products in some markets, and may therefore play a more limited role in competition. This will be particularly important in markets characterised by strong brand loyalty. While the supplier may provide substantial competition for a product overseas, they may only occupy a niche position in New Zealand.

41. Not all markets are subject to effective import competition, and often the impact imports have on competition will be determined by the nature of the product in question. For example, in a merger involving adhesive companies,[44] it was not usually economic to import water-based adhesive fully made, due to the high water content, as it was cheaper to source the raw materials offshore and produce it locally.

42. Furthermore, as noted in an ex post evaluation carried out by the Commission, the profitability of importing, and so the competitive constraint imports are likely to provide, is not independent of the exchange rate.[45] In some matters, the price difference at which imports can profitably be brought into New Zealand may be sufficiently large such that imports will continue to provide competitive constraint regardless of most exchange rate fluctuations. In other matters, imports may be more vulnerable to reasonably small variations in exchange rates.

43. The Commission faced an uncommon situation in a wool scour merger in that the possibility of greasy wool being exported was recognised as a potential constraint on the merging parties, two New Zealand wool scours.[46] If scouring in New Zealand became too expensive, wool merchants could export un-scoured (greasy) wool to carpet manufacturers and other end users, or could have the wool scoured more cheaply overseas, particularly in China. It was found that additional transport costs of exporting greasy wool were relatively insignificant and would not present a substantial barrier to increased greasy exports. The Commission recognised that the Chinese scouring industry posed a significant long term competitive threat to the domestic industry in New Zealand.[47]

44. The Commission considers imports from the point of view of a potential exporter, as well as from the perspective of New Zealand based importers and users. The ways in which imports can constrain a merged entity will be split into the following categories for the purposes of discussion:

- an overseas supplier could choose to export to New Zealand
- a New Zealand firm could import from overseas
- consumers based in New Zealand could import directly.

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[44] *H. B. Fuller Company Australia Pty Limited and Advanced Adhesives (New Zealand) Limited* [2016] NZCC 8. https://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/925

[45] Lilla Csorgo and Harshal Chitale, “Targeted Ex Post Evaluations in Data Poor World” (Commerce Commission) at [16]. http://www.comcom.govt.nz/the-commission/media-centre/speeches/targeted-ex-post-evaluations-in-a-data-poor-world/

[46] *Cavalier Wool Holdings Limited and New Zealand Wool Services International Limited* [2015] NZCC 31. http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/authorisations/merger-authorisation-register/detail/848

[47] Ibid, at [234].

4.1 Overseas supplier exporting to New Zealand

45. A supplier based offshore that could export to New Zealand cannot be assumed to be part of the defined geographic market as there are too many factors at play. Suppliers have competing priorities, such as capital and management resources, and it may be more profitable for the firm to use their excess capacity supplying other markets. The availability and the profitability of imports into New Zealand are not independent of local conditions in the export market, and exporters can be quite vulnerable to variations in these conditions.[48]

46. Additionally, there can also be discontinuity in supply when it comes to exporting. In some markets, an overseas supplier may be able to make opportunistic shipments to New Zealand, or to supply a niche segment of the market. However, these may not constitute a significant and ongoing competitive constraint if the supplier has not established their own distribution network. Another factor that can influence whether or not a supplier is able to expand into New Zealand is the existence of intellectual property rights.

47. In a brick merger case, Australian clay brick manufacturers were considered by the Commission as near competitors.[49] In examining the constraint provided from Australian brick manufacturers, the Commission took into account the Import Parity Pricing ('IPP'), and found that prices in New Zealand were very similar to the IPP.[50] The Commission's ex post review looked at this and found that one brick company had merged with the Australian branch of the merged entity and the associated plant was shut down.[51] Another company changed its production system so that producing New Zealand standard-sized bricks had become problematic. The third company simply indicated that it was no longer interested in exporting to New Zealand. A New Zealand-based importer did, however, enter the market on a limited scale based on imports from China.

48. From the bricks merger, the Commission learned that when relying on imports as a source of competition, particularly if it is a new import source, greater attention should be paid to market conditions that drive export decisions and possible variations in these.[52] While this is relevant in all import cases, it is particularly so when the imports being relied upon are those that are to be spearheaded by the foreign-based firm. In such a case, relevant factors in assessing the likelihood, extent and timeliness of such imports include:

- the firm's business plans
- the process (and the associated time) by which export decisions are made, including any possible variation in those decisions
- the firm's financial condition.

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48 Above n 45 at [21].

49 *CSR Building Products (NZ) Limited and Brickworks Building Products (NZ) Pty Limited* [2012] NZCC 30 at [45]. http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/761

50 Ibid, at [65].

51 Above n 45 at [22].

52 Ibid, at [23].

49. The possibility of overseas-based suppliers entering the market in New Zealand post acquisition was also looked at in a decision involving plastic pails.[53] It was found that several Australian-based suppliers would be unlikely to enter the New Zealand market as they preferred to focus on expansion in the much larger Australian market. They noted that the relatively high freight costs between Australia and New Zealand, and the difficulty in competing against a merged entity, with a strong established presence and surplus capacity, would be disincentives to their entry.

4.2 Importing by suppliers located in New Zealand

50. One explanation for New Zealand based importers being less vulnerable than firms located overseas to changing conditions in foreign markets is that the New Zealand importer typically only decides to import when it is certain of supply, so any relevant change in the foreign market will have typically already played out at the time of the import decision.[54] In the ex post review it was found that in the case of New Zealand-based importers, relevant questions should address:

- the certainty of supply, including any contracts;
- the length of those arrangements; and
- the flexibility around increasing imports.

51. In the plastic pails determination, various factors were taken into consideration by the Commission as to whether a New Zealand based supplier, NCI, had the potential to provide competition in the market post acquisition by expanding its importation of pails.[55] It was found that NCI was a large participant in the Australian plastic pails market that manufactured the required range of plastic pail sizes. NCI also had a proven record of reliable supply and established relationships with large paint purchasers with regard to the supply of tin pails in New Zealand and Australia, and could provide a bundle of tin and plastics pails that would be attractive to large paint purchasers.

52. Upon further analysis, the Commission came to the conclusion that NCI would not provide a strong competitive constraint on the merged entity. NCI admitted that its expansion in New Zealand post acquisition would continue to be hampered by the higher costs of its imported pails compared to the costs of those produced in New Zealand by Pact and Viscount NZ. As well as transport costs, NCI maintained that capacity constraints and incumbent responses would prevent further expansion.[56] The Commission decided in this case to clear the merger, subject to a divestment.

4.2 User self-supply by directly importing

53. The ease with which a user of a particular product can import directly into New Zealand will depend on the type of user, and the type of product. Generally speaking, it may not make economic sense for a consumer to import directly rather than buying from an established supplier, unless they require large quantities of the good, and it is relatively cheap to import.

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[53] Above n 1 at [215].

[54] Above n 45 at [21].

[55] Above n 1 at [138].

[56] Ibid, at [155].

54. In the plastic pails case, it was found that most large purchasers had not considered the option of direct importing.[57] However, some food and industrial pail purchases stated that in the face of a price increase post acquisition, direct importing could be a realistic option. One purchaser advised the Commission that, if faced with pail price increases, they had the necessary infrastructure in South East Asia to source plastic pails from that region and would not require a third party distributor to organise such imports. There were, however, some concerns around the length of the importing process, as well as the quality of the product.

55. The Commission considered that these large food and industrial manufacturers would have a degree of countervailing power over the merged entity through their ability to self-supply through imports.[58] This was because they were well informed purchasers with experience of self-supply via importing, had established logistics networks, and purchased large volumes of pails that did not need high quality labelling.

56. In contrast to these views, paint purchasers, both small and large, indicated that their requirements for regular and consistent supply of high quality plastic paint pails meant that it would take a significant price increase by their domestic supplier before they would consider direct importing, due to inherent risks. [59] One purchaser was concerned that overseas suppliers could not assure certainty of supply, because some factors affecting delivery were beyond their control. The longer and more occasional the supply chain, the greater the risk of interruption. This was particularly relevant for the paint industry as sales of paint undergo significant seasonal variations. Several industrial purchasers indicated that the costs of managing currency exchange rate fluctuations, freight costs, lead times, and warehousing costs were prohibitive to their importing.[60]

57. The Commission cleared an acquisition involving two steel companies; leaving New Zealand with only one manufacturer of certain types of steel products. In reaching this decision, the Commission examined the extent to which imports could prevent any increase in market power by a merging party. Steel imports were established and easy to expand. It was noted that steel distributors in New Zealand reference import parity pricing (IPP) when setting domestic prices.[61] Steel buyers (mainly distributors) advised that they had discussions about the IPP with the merging parties to ensure the prices they obtained were reasonable. Many of the market participants sourced steel products manufactured overseas in addition to those manufactured by the merging parties.[62] Some of the firms processed the steel into final products, so could be considered to be self-supplying through imports. Others distributed the products without any processing, so were importing for the purpose of on-selling.

5. Trans-Tasman markets

58. As noted in several of the examples above, import competition from Australia is often an important constraint on a market. The Closer Economic Relations agreement signed in 1983 has helped achieve free trade in goods and services between New Zealand and Australia, and includes measures to

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57 Ibid, at [185].

58 Ibid, at [239].

59 Ibid, at [187].

60 Ibid, at [190].

61 *Bluescope Steel (NZ) Limited and Pacific Steel Group* [2014] NZCC 8 at [94]. http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/812

62 Ibid, at [33].

unify policy, laws and regulatory regimes in both countries.[63] For example, there are lower compliance costs for food exporters due to the Food Standards Treaty.[64] Section 36A of the Commerce Act and Section 46A of the Competition and Consumer Act in Australia have replaced anti-dumping regulations between the two countries with provisions covering taking advantage of substantial market power in trans-Tasman markets.

59. Despite this close relationship, the extent of trans-Tasman competition has not generally, to date, resulted in markets being defined as trans-Tasman. One example of a case where import competition from Australia did not necessarily imply a broader geographic market was in a lubricant acquisition decision, which was declined by the Commission.[65] The acquisition would have seen Reckitt Benckiser, suppliers of the Durex range of personal lubricant, acquire Johnson and Johnson's K-Y lubricant brand. K-Y Jelly sold in New Zealand is manufactured in Australia. However, the market for personal lubricant products is characterised by strong brand loyalty and the market structure was quite different in Australia, where the equivalent merger was cleared by the Australian Competition and Consumer Commission.[66]

60. In the Commission's decision, it was found that there were no significant manufacturing barriers to entry or import barriers. Most personal lubricant brands sold in New Zealand are manufactured overseas (on contract by third-party manufacturers). In addition, existing lubricant suppliers did not appear to have any capacity constraints that would prevent them expanding.[67] However, the Commission considered that brand recognition and consumer loyalty were conditions of entry and expansion that a supplier must navigate.[68] Negotiating this condition would require considerable sunk investment in promotion and advertising, with no guarantee of success.[69] The Commission could not identify any other major suppliers in New Zealand or Australia that were likely to attempt large scale entry.[70]

6. Conclusion

61. Markets are defined in New Zealand by reference to supply and demand side substitution. While the Commerce Act defines a market as a market in New Zealand, this does not mean a market must be confined to within New Zealand's borders. In most cases, substitution has not been sufficient to extend the market beyond New Zealand, even to a trans-Tasman market. However, import competition often acts as a significant constraint on merged entities.

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63 New Zealand Foreign Affairs and Trade, "NZ-Australia Closer Economic Relations (CER)". https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-in-force/nz-australia-closer-economic-relations-cer/

64 Food Standards Australia New Zealand, "Food law, treaties and agreements". http://www.foodstandards.govt.nz/about/foodlawandtreaties/Pages/default.aspx

65 *Reckitt Benckiser Group Plc and Johnson and Johnson* [2015] NZCC 12 http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/824

66 Australian Competition and Consumer Commission, "Reckitt Benckiser Brands Limited - proposed acquisition of K-Y brand from Johnson & Johnson". http://registers.accc.gov.au/content/index.phtml/itemId/1182033/fromItemId/751043

67 Above n 65 at [155].

68 Ibid, at [156].

69 Ibid, at [159].

70 Ibid, at [171].