

Statement of Preliminary Issues

DLF Seeds A/S / PGG Wrightson Seeds Holdings Limited

11 October 2018

Introduction

1. On 1 October 2018, the Commerce Commission registered an application (the Application) from DLF Seeds A/S (DLF) seeking clearance to acquire 100% of the shares in PGG Wrightson Seeds Holdings Limited (PGW Seeds) from PGG Wrightson Limited (the proposed acquisition).¹
2. The Commission will give clearance if it is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. We invite interested parties to provide comments on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **25 October 2018**.

The parties

DLF

5. DLF is a Danish company owned by a cooperative of Danish grass-seed farmers, dealing in forage and amenity seeds, and other crops. It operates either directly or through its subsidiaries in 20 countries around the globe.
6. DLF began operations in New Zealand in 2004. It has an office based in Christchurch and a breeding station at Yaldhurst.

PGW Seeds

7. PGW Seeds is a New Zealand company formed in 1990. It is wholly owned by PGW, a company listed on the main equity securities board operated by NZX Limited (ticker code: PGW). 50.22% of PGW's shares are owned by Agria (Singapore) Pte Limited.
8. The PGW Seeds business is one of the largest proprietary seed companies in the southern hemisphere, servicing both New Zealand and global markets. The PGW Seeds business focuses on Australasian and South American seed growing and

¹ A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

producing, and it has a strong presence in New Zealand, Australia, Argentina, Uruguay and Brazil.

Our framework

9. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.³ As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
10. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).⁴ This allows us to assess the degree by which the proposed acquisition might lessen competition.
11. If the lessening of competition as a result of the proposed acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
 - 11.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
 - 11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 11.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

Market definition

12. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.⁵
13. In the Application, DLF submitted that in respect of forage seeds, the relevant markets are national markets for the production or importation and wholesale supply of each of;
 - 13.1 Ryegrass/Tall Fescue seed;

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

⁴ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁵ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

- 13.2 Clover seed;
 - 13.3 Brassica/Fodder beet seed; and
 - 13.4 Cocksfoot seed (*together, the forage seed markets*).
14. In respect of turf seeds, the Applicant submitted that the relevant market is the production or importation and wholesale and retail supply of Turf seed.
15. The Commission has previously considered markets relating to forage seeds. In 2005, in Decision No. 556,⁶ the Commission found that there are separate markets for clover seed, brassica and ryegrass.
16. In the current case, in assessing the scope of the relevant product markets, in relation to forage seeds, issues we will examine will include:
- 16.1 whether it is appropriate to consider ryegrass and tall fescue seeds in the same market (which has been submitted by the applicant) or whether these two seed types constitute discrete markets;
 - 16.2 whether it is appropriate to consider brassica and fodder beet seeds as being in the same market (which has been submitted by the applicant), or whether these two seed types constitute discrete markets;
 - 16.3 in Decision No. 556, the Commission considered whether it was necessary to define separate product markets for ryegrass seeds that were inoculated with different endophytes, and ultimately decided it was not necessary. We will consider whether this is still the case;
 - 16.4 whether proprietary and non-proprietary forage seeds should be in discrete markets; and
 - 16.5 in respect of the geographic scope of the market, the extent to which regional climate differences within New Zealand affect the ability of different grass varieties to perform in particular areas, which may suggest regional markets.
17. In assessing the scope of the relevant turf seed market/s, issues we will examine will include:
- 17.1 whether there are different markets for turf seeds based on end use. For example, whether there may be a premium turf seed market for specialist uses (for example, golf courses or sports fields) as opposed to grass seed used by a council on a berm; and
 - 17.2 whether forage seeds can be substituted in these end use applications.

⁶ Decision 556 - Application for Merger Clearance - Pyne Gould Guinness and Wrightson - 31 August 2005.

Without the acquisition

18. We will consider the likely scenario if the acquisition does not proceed. In particular, we will assess whether PGW Seeds would be retained and operated by its current owner or sold to an independent third party (both the equivalent of the status quo), or whether there is another likely scenario.

Preliminary issues

19. We will investigate whether the proposed acquisition would be likely to substantially lessen competition in the relevant markets by assessing whether horizontal unilateral or coordinated effects might result from the proposed acquisition. The questions on which we will be focusing are:
- 19.1 *unilateral effects*: would the loss of competition between the parties enable the merged entity to profitably raise prices of its seeds or to reduce the quality of the products it produces now or will produce in the future (for example, by reducing its investment in research and development);⁷ and/or
- 19.2 *coordinated effects*: would the proposed acquisition change the conditions in the relevant markets so that coordination between market participants is more likely, more complete or more sustainable?

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

20. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger. A merger could also reduce competition if one of the merging firms was a potential or emerging competitor, which may provide stronger competition in the future.
21. The parties overlap in the supply of forage seeds and the supply of turf seeds. In its Application, DLF submitted that the proposed acquisition would be unlikely to substantially lessen competition in any of the relevant markets due to unilateral effects.
22. In relation to the forage seed markets, DLF submitted that:⁸
- 22.1 DLF is a small player in New Zealand, and the proposed acquisition would therefore result in only a small degree of aggregation above PGW Seeds' existing strong position;

⁷ For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or its rate of innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

⁸ The Application at paras 12 - 15.

- 22.2 there would continue to be a significant degree of competition provided by other suppliers of forage seeds including Agriseeds, Seed Force, Cropmark and Germinal;
 - 22.3 barriers to entry, and barriers to expansion for existing competitors are low, there are existing multinational competitors that are well placed to enter New Zealand and imports are readily available; and
 - 22.4 there is also competition from suppliers of non-proprietary seeds such as Cridge Seeds, Wesco, Frame Grain & Seeds and others.
23. In relation to the supply of turf seeds, DLF submitted that:⁹
- 23.1 the market is extremely diverse, with a diverse customer base and multiple channels to market;
 - 23.2 both proprietary and non-proprietary varieties of seed are common;
 - 23.3 imports are prevalent, including from suppliers in the USA and Australia; and
 - 23.4 there are low barriers to entry into the turf seed market, and there are existing multinational competitors that are well placed to enter New Zealand.
24. In assessing whether the proposed acquisition would be likely to give rise to unilateral effects, we will consider the following factors.
- 24.1 Closeness of competition: the degree of constraint that DLF and PGW Seeds currently impose upon one another. To the extent that any constraint is material, we will assess whether the lost competition between the merging parties could be replaced by rival competitors. We will also assess the extent to which they might compete with each other in the future with products in their development pipelines;
 - 24.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity, including through their research and development activities;
 - 24.3 entry and expansion: whether or not entry or expansion is likely to happen on a sufficient scale and within a reasonable time period such that it would constrain the merged entity. In particular, we will examine whether the supply of imported seed is able to constrain suppliers which have local research and development programs. That is, whether seed that is not specifically developed for New Zealand climatic and environmental conditions and disease profiles is an effective constraint on seed developed locally, and whether this varies by market.

⁹ The Application at paras 16 – 22.

Coordinated effects: would the proposed acquisition make coordination more likely?

25. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.¹⁰
26. We will assess whether any of the relevant market/s are vulnerable to coordination, and whether the proposed acquisition would change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable. Some of the factors we will consider are:
- 26.1 monitoring mechanism – in order for coordination to be sustainable, suppliers must be able to detect if other rivals are acting differently to the higher price or market sharing equilibrium and punish a supplier who deviates. The level of transparency of prices in the relevant markets will therefore need to be assessed;
- 26.2 internal stability – suppliers must have an incentive to coordinate. This is most likely when firms are of similar size and structure and the number of players is low. The degree of overlap and similarity between the operations of seed suppliers will be considered; and
- 26.3 innovation – we will examine the level of innovation in the forage and turf seed markets, as markets characterised by high levels of innovation are generally speaking less conducive to coordinated outcomes.

Next steps in our investigation

27. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed acquisition by **28 November 2018**. However, this date may change as our investigation progresses.¹¹ In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
28. As part of our investigation, we will identify and contact parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

29. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference “DLF/PGW Seeds” in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **25 October 2018**.

¹⁰ *Mergers and Acquisitions Guidelines* above n3 at [3.84].

¹¹ The Commission maintains a case register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

30. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
31. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.