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Statement of Preliminary Issues

Heyden/Henergy/Rasmusens

17 August 2020

Introduction

1. On 24 July 2020, the Commerce Commission (the Commission) registered an application from Heyden Farms Limited (Heyden), Henergy Cage-Free Limited (Henergy) and Rasmusens Poultry Farms Limited (Rasmusens) (together, the Applicants) seeking clearance to merge their respective egg production and wholesale supply operations (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 **31 August 2020**.

The parties

5. Heyden, Henergy and Rasmusens are all producers and suppliers of eggs.

    5.1 Heyden supplies cage eggs, barn laid eggs, and free range eggs from its production facilities in the Waikato and the Bay of Plenty. It sells its eggs under the Morning Harvest, Sure as Eggs and New Day Free Range brands, which are owned by the Independent Egg Producers Co-operative (IEP Co-op), of which it is a shareholder.

    5.2 Henergy supplies barn laid eggs from its production facilities near Masterton. It sells its eggs under its Henergy Cage-Free brand.

    5.3 Rasmusens supplies cage eggs and free range eggs from its production facilities near Whanganui. It sells its eggs under the Morning Harvest and New

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[1] A public version of the application is available on our website at: https://comcom.govt.nz/case-register/case-register-entries/heyden-farms-limited,-henergy-cage-free-limited-and-rasmusens-poultry-farms-limited.

[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.

Day brands as part of the IEP Co-op, of which it is a shareholder, as well as the Rasmusens free range brand.

6. In addition to branded eggs, Heyden and Rasmusens (via the IEP Co-op) and Henergy supply eggs on a private label basis to supermarkets.

Our framework

7. 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.

8. 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.

9. 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:

   9.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;

   9.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

   9.3 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

10. 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 1986, as a matter of fact and commercial common sense.[5]

11. The Applicants submitted that the relevant market is the national market for the production and wholesale supply of eggs. However, the Applicants also acknowledge

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3 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. 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].

that it might be appropriate to assess narrower markets based on the farming method used to produce the relevant eggs (i.e. cage eggs, free range eggs etc). The Applicants submitted that even if narrower markets are defined by the Commission, there would be sufficient constraints in any relevant market such that competition issues are unlikely to arise from the Proposed Acquistion.

Product dimension

12. At present, there are four farming methods used to produce eggs in New Zealand, although one of these methods is being phased out and another will no longer be supported by the major supermarket chains in the long term. All existing methods adhere to the Government-mandated quality and welfare requirements, which are outlined in Animal Welfare (Layer Hens) Code of Welfare 2012 (Code of Welfare).[6] The four methods are:

    12.1 cage system eggs – produced by hens living in cages that do not have perches, nest boxes or catching areas. Cage systems are being phased out and the Code of Welfare requires them to be decommissioned by 2022;

    12.2 colony raised eggs – produced by flocks of hens living in colony cages where they have greater space, perches, nest boxes and scratching areas but do not roam outside. While not mandated under the Code of Welfare, both major supermarket chains in New Zealand have announced that they will be phasing out the sale of colony raised eggs in the long term;

    12.3 barn raised eggs – produced by hens living in flocks that are free to roam inside a barn with access to perches, nest boxes and scratching areas but do not roam outdoors; and

    12.4 free range eggs – produced by hens living in flocks that are free to roam and access perches, nest boxes, scratching areas and the outdoors.

13. On the demand side, we will consider the degree to which consumers switch between the different type of eggs. On the supply side, we will consider the substitutability of the different production methods used to produce eggs in New Zealand. We will test whether there should be one broad market for the wholesale production and supply of eggs, or more narrowly defined markets based on production method.

Geographic dimension

14. The Applicants submitted that, regardless of the definition of the product market(s), the geographic scope is national because:

    14.1 freight costs are not currently acting as a meaningful barrier to supplying eggs across both the North and South Islands, which means that the location of production facilities does not dictate the reach of a producer;

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6 See https://www.mpi.govt.nz/dmsdocument/1438/direct and Egg Producers Federation of New Zealand.

14.2 for small customers located in a single region, eggs supplied from neighbouring regions throughout the country are substitutable for each other; and

14.3 major customers procure eggs on a nationwide basis.

15. We will test whether the geographic scope of any market is national or whether there are narrower markets, for example by island or by region. For each production method, we will consider the extent to which location impacts on how closely producers compete with one another.

Customer and functional dimensions

16. We understand there are two main customers for eggs – supermarkets and food service customers. The Applicants consider that there is no need to separate any markets into particular wholesale or customer groups as both supermarket and food service customers have, essentially, the same supply alternatives.

17. We will test whether different customers (supermarkets, food service customers etc) have distinct requirements such that they comprise discrete markets.

Without the acquisition

18. The Applicants consider that the status quo is the appropriate counterfactual in this case. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo or whether the counterfactual may be something other than the status quo.

Preliminary issues

19. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market(s) by assessing whether horizontal unilateral and/or coordinated effects might result from the Proposed Acquisition.

Horizontal unilateral effects

20. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint such that the merged firm can profitably increase price above the level that would prevail without the merger. The question that we will focus on is would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?[7]

21. The Applicants submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any relevant market due to unilateral effects because, post acquisition:

[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 innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

21.1 there would be a range of existing competitors across the country, utilising different business models and production methods, that would constrain the merged entity;

21.2 existing competitors are expanding and there are limited barriers to further entry and expansion; and

21.3 major customers have significant countervailing power, which means that egg producers are 'price takers'.

22. We will consider:

22.1 the degree of competitive constraint that Heyden, Henergy and Rasmusens impose upon one another. To the extent that any constraint is material, we will assess whether the competition lost between the merging parties could be replaced by rival competitors;

22.2 how easily rivals could enter and/or expand in response to a price increase by the merged entity and whether that is likely in a timely manner; and

22.3 the extent to which customers have special characteristics that would enable them to resist a price increase by the merged entity, such as sponsoring new entry or expansion.

Coordinated effects

23. 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 prices increase across the market.

24. The Applicants submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any market due to coordinated effects primarily because of the number of existing competitors post acquisition, the lack of transparency in the industry and the countervailing power of the main customers.

25. We will assess whether the Proposed Acquisition would make coordination more likely, more complete or more sustainable. As part of our assessment we will consider whether the relevant market(s) are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant market(s). In particular, we will assess whether the Proposed Acquisition:

25.1 would make it easier for competitors to monitor and punish the behaviour of rivals in relation to particular products such that coordination would be more likely as a result of the Proposed Acquisition; and

25.2 would establish a focal point for competitor behaviour, or change the conditions in a market, such that coordination would be easier and/or more likely as a result of the Proposed Acquisition.

Next steps in our investigation

26. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **18 September 2020**. However, this date may change as our investigation progresses.[8] In particular, if we need to test and consider further the issues identified above, the decision date is likely to extend.

27. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

28. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Heyden/Henergy/Rasmusens" 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 **31 August 2020.**

29. 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.

30. 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.

[8] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.