PUBLIC VERSION
ISSN NO. 0114-2720
J3588

COMMERCE COMMISSION

Decision No. 371

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

Richmond Limited

and

Waitotara Meat Company Limited

The Commission: P R Rebstock

Summary of Proposed Acquisition: The acquisition by Richmond Limited or interconnected body corporate, of up to 100% of the shares in Waitotara Meat Company Limited.

Determination: Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition

Date of Determination: 6 September 1999

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS [ ]

THE PROPOSAL

1. Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Richmond Limited (Richmond) gave notice to the Commission dated 23 August 1999 (the application), seeking clearance for it, or an interconnected body corporate, to acquire up to 100% of the shares in Waitotara Meat Company Limited (Waitotara).

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 the notice agree to a longer period. No extension was sought by either party. Accordingly, a decision on the application is required by Monday 6 September 1999.

3. In the application, Richmond sought confidentiality for the fact of the application, and for market share information. However, an accompanying letter amended the confidentiality request to cover the market share only. A confidentiality order was made in respect to the market share information contained in the application, for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's determination is based on an investigation conducted by its staff and their subsequent advice to the Commission. Commission staff discussed the proposed application with the following parties: AFFCO, Federated Farmers, the Meat and Wool Economic Service of New Zealand, and a Stock Agent.

THE PARTIES

Richmond Limited

5. Richmond is a farmer owned meat-processing company, with approximately 1740 shareholders. Its corporate office is situated in Hastings. A company representing Maori pastoral interests, HKM Nominees No 1 Limited, holds 30.8% of the equity capital. A South Island meat company, PPCS, holds one third of the shares of HKM Nominees, and has an option to acquire a further one third. Toocoya Nominees Limited, which represents the farming interests of Mr John Spencer, holds 13% of Richmond's shares.

6. In 1998, Richmond was ranked as the 40th largest company in New Zealand in terms of revenue.[1]

7. Richmond procures and processes stock at nine plants situated throughout the North Island. Richmond's main sheep meat plants are situated in the Hawkes Bay. The company is also a large processor of beef. It processes about 30% of the beef herd, and less than 15% of the national sheep flock. The company supplies the local market and overseas markets with processed products.

[1] "1998 Top 200 New Zealand Companies", Management December 1998, 76

8. Richmond operates a sheep and lamb pelt processing fellmongery at Shannon.

9. In February 1998, Richmond acquired another North Island meat processing company, Lowe Walker New Zealand Limited (Commission Decision No. 316). Richmond has rationalised some of the acquired assets.

Waitotara Meat Company Limited

10. Waitotara is a farmer owned company with in excess of 100 direct or indirect (via Waitotara Farmers Holding Company Limited) shareholders. Waitotara was formed in 1987 by Mr Rod Pearce who remains the largest shareholder with a 19.7% direct shareholding, and a 56% shareholding in Waitotara Farmers Holding Company Limited, which holds 51.4% of Waitotara's shares. Richmond currently has a 10.9% shareholding in the company.

11. Waitotara operates sheep meat plants at Waitotara near Wanganui, and at Tirau, in the Waikato. The company also procures and 'toll processes' lambs for Richmond under a contract Richmond acquired when it acquired Lowe Walker. This contract accounts for about 25% of processed stock at the Waitotara plant.

12. Waitotara also processes sheep and lamb pelts at the 50% owned, Hollander Waitotara Processing Limited fellmongery, situated at Wanganui.

BACKGROUND

The Sheep Meat Industry

13. The sheep meat industry plays an important role in the New Zealand economy. In the 1997-98 year, lamb exports were the second to largest exported item in dollar terms. Lamb exports returned $1,289m whilst mutton exports returned $194m.[2] There were 289 million tonnes of lamb exported, and 63 million tonnes of mutton exported.[3] About 80 percent of both lamb and mutton produced in New Zealand in 1997-98 was exported.[4]

14. Trends in livestock numbers are largely determined by world market prices for farm products. Over the period from June 1982 to June 1998, the sheep population has declined from 70.3 million to around 46.2 million.[5] This has resulted in a falloff in demand for processing capacity The distribution of the sheep population in New Zealand is summarised in Table 1. The North Island accounts for about 45 percent of total sheep numbers.[6]

---

[2] The New Zealand Meat Producer, *The Business of New Zealand Meat*, March 1999 Vol 27 No. 1 3.
[3] A lamb is a young sheep under 12 months of age or one that does not have any permanent incisor teeth in wear. Mutton, includes ewes and castrated males (wethers) with more than two permanent incisors in wear.
[4] <http:www.stats.govt.nz/domino/ex…/>
[5] Ibid
[6] Op cit note 2, at 6

Table 1
Sheep Numbers in New Zealand 1998

Region	Sheep Numbers (000's)	Percent of Total
Otago/Southland	13,825	29%
Canterbury/Westland	11,950	25%
Taranaki/Manawatu	4,600	10%
East Coast of North Island	10,140	22%
Nth/Sth Auckland	6,420	14%

Source: Meat New Zealand

The Meat Slaughtering and Processing Industry

15. There are presently 25 companies within New Zealand which process meat for export. Fifteen of these are processor-exporters, and 10 process for export, by licensed exporters. A similar number of smaller companies are involved in processing meat for the local market. In addition some companies undertake further processing of meat.

16. There are 21 plants involved in sheep meat processing in the North Island, which are owned and operated by 13 companies.[7] AFFCO and Richmond are the two largest North Island companies, with a combined market share of [ ] in the North Island sheep processing market.

17. In the slaughter process the animal must be killed and the meat processed in accordance with hygiene, animal welfare, and, in some cases, religious requirements in both New Zealand and the importing countries. Systems exist to deal with the quota requirements which apply in some importing countries.[8]

18. A characteristic of the industry is its seasonal nature. As farmers must use grass when it grows, and reduce stock numbers when it does not, they require an industry capable of killing virtually on demand. Such a system must have a very high capacity in the peak season, during autumn. As a result, the processing companies have plant which is under-utilised for most of the year. In the periods on either side of the peak, called the "shoulder" periods, the marginal cost of killing is below the average cost. When this happens, the companies actively seek stock.[9]

19. Better weather in the North Island means the sheepmeat processing season runs up to three months longer than in the South. This offers advantages for exporters who are able to target the high-priced chilled lamb markets, and this is reflected in the comparative price advantage for North Island lambs. The 1997-98 weighted average payments per head for North Island export lamb were $43.40, and for South Island export lamb the figure was $36.68.

---

[7] Op cit note 2, at 14-15
[8] C W Maughan, *The Structure and Dynamics of New Zealand Industries* (Bollard, Pickford, 1st ed, Dunmore Press, Wellington, 1998) 32
[9] Ibid at 40

THE RELEVANT MARKETS

Introduction

20. The purpose of defining a market is to provide a framework within which the competition implications of a business transaction can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would likely to result, in the acquisition or strengthening of a dominant position in terms of s 47(1) of the Act in any market.

21. Section 3(1A) of the Act provides that:

> "Every reference in this Act, except the reference in section 36A(1)(b) and (c) of this Act, 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."

22. The section was considered in the High Court decision of *Telecom v Commerce Commission.*[10] The Court stated that firstly the areas of close competition must be identified, the constraints upon price and production policies of firms must be considered.[11] The Court stated that competition may proceed both through substitution in demand and substitution in supply in response to changing prices, or the price-product-service packages offered. The Court suggested that a mental test that prompted a summary evaluation of the evidence was to ask how buyers and sellers would likely react to a notional small percentage increase in the price of the products of interest.[12] Finally, the Court stated that the market was a multi-dimensional concept, with dimensions of product, space, functional level, and time.[13]

23. The Commission will seek to define relevant markets in terms of the goods or services supplied and purchased, the geographic area from which the goods or services are obtained, or which they are supplied, and the level in the distribution chain.[14]

24. The Commission's approach to market definition concentrates on demand side factors or purchaser reactions. Supply side factors are generally considered at the stage when market participants, including near entrants, are identified, and in the consideration of the constraints from market entry.[15]

25. In defining a relevant market it is important to determine the level of substitutability for a particular good, service or geographic region. A relevant market is the smallest space defined within which a hypothetical profit-maximising sole supplier of a good or service would impose at least a small yet significant and non-transitory increase in price (*ssnip*).

---

[10] (1991) 4 TCLR 473, 499
[11] Ibid at 501
[12] Ibid at 502
[13] Ibid at 503
[14] Commerce Commission, *Business Acquisition Guidelines*, 1999, 11
[15] Ibid at 12

Consideration of buyer reaction to such a hypothetical price rise provides a more formal framework for the process of market definition, and is likely to make better use of whatever empirical evidence is available than impressionistic assessments. The Commission will generally consider a *snipp* to involve a 5 percent increase in price for a period of a minimum of one year.[16]

26. The process of defining relevant markets is unlikely to be as precise and scientific as suggested by the *ssnip* test. The test sets out a framework within which case-by-case judgements must occur. Those judgements will involve consideration of a range of evidence including: estimates of price elasticity; price trend data; consumer surveys; and observation and informed opinion. Finally, a market will be determined as a matter of fact and commercial common sense.[17]

27. Markets are also defined in relation to functional level. The distribution and sale of products occurs through a series of functional levels, between manufacturer and wholesaler (manufacturing market), between wholesaler and retailer (wholesale market), and between retailer and consumer (retail market). The Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.[18]

Product/Function Market

Introduction

28. The applicant submits that horizontal aggregation would occur in the following markets:

- the procurement of sheep and lambs for slaughter and processing in the North Island;
- the wholesale supply of meat products in New Zealand; and
- the international marketing of meat products.

Section 3(1A) of the Act states that every reference in the Act to the term "market" is a reference to a market in New Zealand for goods and services. As the market for the international marketing of meat products is not a market in New Zealand, it will not be considered further in this analysis.

29. The Commission considers that there is also some aggregation in the market for the supply of fellmongery services.

Procurement of Lambs and Sheep for Slaughtering and Processing

30. Commission Decision 273 of 2 February 1995, (which authorised the acquisition and closing of the Weddel processing plants by a consortium of meat processing companies), defined one of the relevant markets as being the market for the procurement of sheep and lambs for slaughter and processing in the North Island.

---

[16] Ibid at 14
[17] Ibid at 15
[18] Ibid at 14

31. Commission Decision 316 (Richmond's acquisition of Lowe Walker), defined a further market as being the market for the wholesale supply of meat products in New Zealand.

32. The markets defined in these two decisions continue to be relevant for the present application. The majority of sheep numbers in the North Island are situated on the East Coast and within the central region. There is a large movement of sheep and lambs within these areas, reflecting availability, price, relative transport costs, and the desire of companies to maximise throughput in their different plants.

33. There is some movement of sheep and lambs between the North and South Islands, but, in relation to livestock numbers, the movement is not significant. The cost of transporting livestock across Cook Strait varies, principally according to whether back loads are available to the carriers, but can add up to $6 per lamb. Inter- Island transfers will be viable only where the transport cost is less than the difference in procurement costs in each Island.

Wholesale Supply of Meat Products in New Zealand

34. The market for the wholesale supply of meat by processors would be New Zealand wide due to the low relative cost of transport.

The Supply of Fellmongery Services to the North Island

35. Fellmongery involves the chemical processing of sheep and lamb pelts to remove the wool. Once the wool is removed, the pelts are further processed at a tannery. In some cases, sheep and lamb pelts are moved around the North Island for fellmongery processing. Transport costs are low relative to the delivered cost of a pelt, and the market appears to be North Island wide.

Conclusion on Market Definition

36. The Commission concludes that the relevant markets for consideration of this application are:

- the market for the procurement of sheep and lambs for slaughter and processing in the North Island;
- the market for the wholesale supply of meat products in New Zealand; and
- the market for the supply of fellmongery services in the North Island.

ASSESSMENT OF DOMINANCE

Introduction

37. The assessment of dominance examines how competition in the relevant markets will be affected by the proposed business acquisition, in order to determine whether an acquisition or strengthening of dominance would, or would be likely to, result.

38. Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to give clearance for a proposed acquisition if it is satisfied that the proposed

acquisition would not result, and would not be likely to result, in a person acquiring or strengthening a dominant position in a market. If the Commission is not so satisfied, clearance must be declined.

39. The concept of competition is defined in section 3(1) of the Act as meaning "workable and effective competition". In interpreting this section the Court of Appeal has stated:[19]

> "That encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency."

40. Section 3(9) of the Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has, or 2 [ ] more persons that are interconnected or associated together have, as the case may be, a dominant position in a market if that person as a supplier or an acquirer, or those persons as suppliers or acquirers, of goods or services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is, or 2 or more persons that are interconnected or associated, are, in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:
> (b) The extent to which that person is, or those persons are, constrained by the conduct of competitors or potential competitors in that market:
> (c) The extent to which that person is, or those persons are, constrained by the conduct of suppliers or acquirers of goods and services in that market."

41. The legal test for dominance has been considered by the courts on several occasions. In *Commerce Commission v Port Nelson,*[20] McGechan J, stated that "dominance" involved more than market power, more than an ability to behave largely independent of competitors; and more than power to effect appreciable changes in terms of trading. He stated that "dominance" involved a high degree of market control.

42. McGechan J stated that a firm must be able to set terms of trading independently of significant market constraints. The dominant firm must be able to set prices or conditions without significant constraint by competitors or consumers. He stated that it does not require competition to be so slight as to be of no consequence; it allows for the presence of competition so long as it is below the level at which it is a significant constraint.[21]

43. This decision of McGechan J was affirmed by the Court of Appeal.[22] The Court stated that a dynamic analysis of the market was required, also its structure, the concentration of participants, their behaviour and that expected of potential entrants, the nature of the activities encompassed and general circumstances of supply to, and by, the market.[23] The weighting of the factors in section 3(9) paras (a), (b) and (c) of the Act, must vary according to the particular facts. Such weightings called for a practical assessment of the circumstances, of an ability to exercise a dominant influence in one or more aspects of the relevant market.[24]

---

[19] *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565
[20] (1995) 6 TCLR 406, 441
[21] Ibid
[22] (1996) 7 TCLR 217
[23] Ibid at 230
[24] *Telecom Corporation of New Zealand Limited v Commerce Commission* [1992]3 NZLR 429, 444

44. The Commission has acknowledged this test for dominance in its publication *Business Acquisitions Guidelines*, which state:[25]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will able to set prices or conditions without significant constraint from competitor or customer reaction.
>
> A person in a dominant position will be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long term."

Market Share

45. It is the Commission's view that a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situation exists:[26]
    - The merged entity (including any interconnected or associated persons) has less than in the order of a 40 percent share of the relevant market; or
    - The merged entity (including any interconnected or associated persons) has less than in the order of a 60 percent share of the relevant market, and faces competition from at least one other market participant having no less than in the order of a 15 percent market share.

46. Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of market shares, fall within these safe harbours.[27]

47. A dominance assessment for each of the relevant markets follows.

The Market for the Procurement of Sheep and Lambs for Slaughtering and Processing in the North Island

Current Competition

48. Richmond is a large processor of sheep and lambs in the North Island, and has processing facilities at Dannevirke and Takapau. Each plant is able to slaughter two million lambs each year. Richmond has a small sheep processing plant at Napier and two smaller lamb processing plants in Hastings. Richmond has livestock representatives situated all around the North Island to procure stock. In the 1997-98 production year, Richmond was responsible for approximately [ ] of lamb production and approximately [ ] of mutton production.[28]

---

[25] Commerce Commission, *Business Acquisitions Guidelines*, 1999, 21
[26] Ibid at 17
[27] Ibid at 17-18
[28] Meat and Wool Economic Service of New Zealand

49. Waitotara is a smaller processor, with sheep meat plants at Wanganui and Tirau, it was responsible for approximately [ ] for lamb production and [ ] of mutton production. The merged entity would produce approximately [ ] of lamb and [ ] of mutton in the North Island.

50. There is a number of other competitors operating in this market. The largest is AFFCO, which has sheep meat plants situated in Wanganui, Northland, TePuke, Wairoa, and is responsible for approximately [ ] of lamb production and [ ] of mutton production.

51. Smaller sheep meat plants situated around the North Island include Taylor Preston in Wellington, Lamb Packers Feilding Limited, Wallace Meats in Taumarunui, Te Kuiti Meat Processors, Auckland Meat Processors, Coromandel Meat Processors, Capriannah Meats in Opotiki, Progressive Gisbourne Limited, and Frasertown Meat Company in Wairoa. There are also a number of abattoirs, processing stock for their districts. Table 2 situated below summarises the share of production for the participants.

TABLE 2
Estimated Share of Production 1997-98

Company	Lamb	Mutton
Richmond	[ ]	[ ]
Waitotara	[ ]	[ ]
Merged Entity	[ ]	[ ]
AFFCO	[ ]	[ ]
Others	[ ]	[ ]
Total	100.0	100.0

Source: Meat and Wool Economic Service of New Zealand

52. The merged entity’s market share of this market is approximately [ ], and would fall within the Commission’s safe harbour guidelines. This indicator does not raise dominance concerns, but we consider a number of other factors below.

Constraint From Existing Competition

53. The Commission believes that the merged entity would continue to face effective competition in the market, from existing participants. The service offered by each participant is undifferentiated. Present competition is intense in the procurement of sheep and lambs for slaughter, and competitive conditions appear likely to continue if the proposal is implemented.

54. If the merged entity attempted to exercise undue market power, existing competitors could expand their capacity relatively quickly, through the introduction of extra shifts, and the recommissioning of closed plants.

Constraint from Potential Competition

55. A key characteristic of competitive markets is the freedom for new firms to enter quickly when it is profitable to do so, and to exit without impediment when profit conditions deteriorate. Under these conditions, incumbent firms cannot raise prices or reduce prices

without inducing entry, which, by increasing supply, will once more force the price down to the competitive level.[29]

56. In Decision 273, the Commission identified various regulatory and other factors relevant to entry into the meat industry. These included plant licensing for food safety standards, export licensing, export quota and the costs of exiting the industry. The Commission found that these barriers to entry were not onerous, and referred to the significant number of new entrants into the market. Entry barriers continue to be relatively low. Within the past 3 years, Progressive Gisborne Ltd, Crusader Meats New Zealand Ltd, and Capriannah Meats Ltd have all entered the North Island sheep meat processing market.

57. Meat plants are specialised, and are generally located in small rural centres, which means much of the investment in them is “sunk”. As a result, closed meat plants tend to have low resale values which, by attracting new entrants into the industry, can lead to the recycling of plants. This allows excess capacity to persist.[30]Since March 1998 one sheep meat processing plant, AFFCO’s plant at Taumarunui, has been closed.

Conclusion on the Market for the Procurement of Sheep and Lambs for Slaughter and Processing in the North Island.

58. The proposed acquisition would result in some aggregation of market share, but this would be within the Commission’s ‘safe harbour’ guidelines. Competition within the current market is intense, and the merged entity would continue to be constrained by existing participants and the threat of entry.

The Market for the Wholesale Supply of Meat Products in New Zealand

Current Competition

59. This market is fragmented and characterised by a large number of smaller participants. These smaller processors generally supply local regions, whilst the larger processing companies supply the New Zealand market. These larger companies have the capacity to expand supply by diverting production from export if the domestic wholesale price increases.

60. Richmond and Waitotara are predominantly export orientated companies and can be regarded as minor suppliers to the local market. Enquires have established that Richmond’s share of the supply of local lamb is [ ] and its share of local mutton supply is [ ]. Waitotara has a very limited supply to these markets. As Waitotara does not process beef, the only aggregation is in the sheep and lamb segments of the market. The merged entity would have approximately [ ] share of the lamb and mutton segment of the market. When allowances are made for the supply of beef to this market, the market share would be smaller still. The estimated shares for the supply of lamb and mutton are summarised below in Table 3.

[29] Dr M Pickford, “Economics and the Commerce Act”, Compliance, October 1997 (Commerce Commission, Wellington, 1997)
[30] Op cit note 8, at 44

Table 3
Estimated Share for Supply of Lamb and Mutton 1997-98

Company	Lamb	Mutton
Richmond	[ ]	[ ]
Waitotara	[ ]	[ ]
AFFCO	[ ]	[ ]
Other Export Licensed Processors	[ ]	[ ]
Abattoirs	[ ]	[ ]
Total	100.0	100.0

Source: Meat and Wool Economic Service of New Zealand

61. The merged entity's market share would be well inside the Commission's 'safe harbour' guidelines. There are no concerns that the merged entity would acquire dominance in this market as the level of competition between existing participants is high and barriers to entry are not significant. The buyers of the processed product tend to be large retail outlets, who are reasonably concentrated. They exercise a high degree of countervailing power.

Conclusion on the Market for the Supply of Wholesale Meat Products in New Zealand

62. The merged entity would have a market share well within the Commissions 'safe harbour' guidelines, and would face significant competitive constraints from existing competitors and from the threat of entry into the market.

The Market for the Supply of Fellmongery Services in the North Island

63. Richmond operates a fellmongery at Shannon, in the lower North Island. Waitotara has a 50% ownership interest in Hollander Waitotara Processing Limited, and supplies this facility with pelts for processing. There is a large number of processing facilities in the North Island, which would offer constraint to the merged entity.

64. The proposed acquisition is likely to result in minimal aggregation of market share, to a level within the Commission's 'safe harbours'. The merged entity would continue to face effective competition from existing providers of fellmongery services in the North Island.

Conclusion on the Market for the Supply of Fellmongery Services in the North Island

The proposal is unlikely to result in any significant aggregation of market share. Further, it is likely that effective competition from existing participants in the market will continue. The Commission concludes that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

OVERALL CONCLUSION

65. The Commission has considered the impact of the proposed acquisition in the following markets:
- The market for the procurement of sheep and lambs for slaughter and processing in the North Island;
- The market for the wholesale supply of meat products in New Zealand; and
- The market for the supply of fellmongery services in the North Island.

66. Having regard to the factors set out in section 3(9) of the Commerce Act 1986 and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any of the affected markets.

DETERMINATION ON NOTICE OF CLEARANCE

67. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the acquisition by Richmond Limited or interconnected body corporate, of up to 100% of the shares in Waitotara Meat Company Limited.

Dated this 3rd day of September 1999

P R Rebstock
Commission Member