

Commerce Commission

Decision No. 328

Determination pursuant to the Commerce Act 1986 (the Act), and in accordance with a delegation given in terms of s 105 of the Act, in the matter of an application for clearance of a business acquisition involving:

AGRI-FEEDS LIMITED

and

INDEPENDENT MOLASSES LIMITED

The Commission: Kate Brown

Commission Staff: Susan Bowler
Jeff Hamilton

Summary of Proposed Acquisition: The proposed acquisition by Agri-Feeds Limited of all stocks of, and the customer list for, molasses from Independent Molasses Limited.

Determination: Pursuant to s 66(3)(a) of the Act, and in accordance with a delegation granted under s 105 of the Act, the Commission determines to give a clearance for the proposed acquisition.

Date of Determination: 10 July 1998

<p>CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS</p>
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THE PROPOSAL

1. On 30 June 1998, the Commission registered a notice pursuant to s 66(1) of the Commerce Act 1986 (“the Act”) seeking clearance for the acquisition by Agri-Feeds Limited (“Agri-Feeds”) of the stocks of molasses held by Independent Molasses Limited (“IML”), and the customer list for molasses sales of IML.
2. The proposed acquisition also involves arrangements to be entered into between Agri-Feeds and IML under which the storage tank and associated plant of IML in New Plymouth (situated on the wharf) will be leased by Agri-Feeds for a period of 7 years with an option to purchase, and a sublease of a site on which the plant is situated for 5 years with 3 rights of renewal.
3. In addition it is proposed that Agri-Feeds will enter into a contract with one of the shareholders of IML, Hooker Bros Limited (“Hooker Bros”), who will provide road transport for the cartage of molasses until the year 2000. IML and its shareholders will also enter into a restraint of trade not to compete with the existing business of IML in the molasses market.
4. It is also intended that a management agreement will be entered into in which IML will receive, store and process molasses for Agri-Feeds.

THE PROCEDURES

5. Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period.

6. Agri-Feeds sought confidentiality for certain information contained in the notice seeking clearance, and a confidentiality order was made in respect of that information 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 to that information.
7. Pursuant to s 105 of the Act, the Commission delegated its powers to consider and determine the notice seeking clearance to Kate Brown, Commission Member.
8. This report concludes that Commission staff are satisfied that implementation of the proposed acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market. It is recommended that in terms of s 66(3)(a) of the Act, and in accordance with a delegation granted under s 105 of the Act, the Commission gives clearance for the proposed acquisition.

THE INVESTIGATION

9. Staff contacted the following parties in investigating the proposed acquisition:
 - Gardner Smith NZ Ltd;
 - Bulk Storage Terminals Ltd;
 - FIL Industries Ltd;
 - Wonder Distributors Ltd;
 - Kiwi Trading Stores Ltd;
 - Taranaki Farmers Co-op Ltd;
 - NRM Feeds Ltd;
 - PCL Industries Ltd;
 - New Zealand Food Industries Ltd;
 - Federated Farmers;
 - Animal Remedies Board; and
 - Dairying Research Corporation.

10. The parties to the proposed acquisition also provided additional information.

THE PARTICIPANTS

Agri-Feeds Limited

11. Agri-Feeds is a wholly owned subsidiary of Wrightson Limited (“Wrightson”). The company’s main business activities involve the sale of: liquid supplements, including molasses for livestock; dry supplements and feeds for livestock; equipment associated with the livestock industry; and molasses for the production of bread, liquorice and other products.
12. Wrightson is a publicly listed company which provides a broad range of integrated services and products to farmers, including livestock agency and export, wool broking, farm merchandise, farm insurance, grain and seed, stock feed, bloodstock services, and agricultural and horticultural consultancy.

Independent Molasses Ltd (“IML”)

13. IML is owned as to 50% each by Neleon Holdings Limited (“Neleon”) and Hooker Bros. Its main business activity is the sale of bulk and drummed molasses for consumption by livestock.
14. Neleon is owned as to 50% each by Mr Graeme Butcher and his wife Margaret (Gail) Butcher. The Butchers also own 100% of Agricorp Feed Supplements Limited (“Agricorp”), a company which manufactures feed supplements containing molasses from plants at New Plymouth and Hamilton.
15. Hooker Bros, which is based in the Taranaki region, is engaged in the provision of bulk liquid transport services.

OTHER RELEVANT PARTIES

Gardner Smith NZ Ltd

16. Gardner Smith, which is based in Christchurch, is a wholly owned subsidiary of Gardner Smith Pty Ltd of Australia. The company's principal activities are the processing, storage and distribution of tallow. Through the operations of its subsidiary companies, Gardner Smith provides non-hazardous bulk liquid storage services at Auckland, Napier, Picton, Timaru and Bluff. Of relevance to this proposal is that Gardner Smith has been importing molasses into its bulk storage facilities in Auckland, and supplying the product to customers in the upper North Island.

Bulk Storage Terminals Ltd/New Zealand Food Industries Ltd

17. BST and NZFI are both wholly owned subsidiaries of Burns, Philp Pty Ltd, Australia. BST provides bulk liquid storage services in Auckland, Tauranga, New Plymouth and Wellington. NZFI is a major acquirer of molasses for use in the production of yeast.

FIL Industries Ltd

18. FIL, which is owned by Messrs Arthur Jordan and Dave Hancox, operates a bulk storage terminal for molasses in Timaru. The company purchases molasses, and distributes the product predominantly in the South Island.

Other Acquirers of Molasses

19. There are a large number of companies which purchase molasses or molasses-based products for supply to the agricultural sector. These include stock and station agents and other rural trading companies. In addition, stock feed mills purchase the product as an ingredient for the production of certain animal feeds.

THE RELEVANT MARKETS

Overview

20. Molasses is a by-product of the sugar refining process. The product contains between about 38% and 42% sugar content.
21. Most of New Zealand's molasses requirements are sourced from overseas, with the majority being imported from Australia. Some molasses is produced by The New Zealand Sugar Company Ltd ("NZ Sugar") at its refinery in Auckland, but according to Agri-Feeds, supplies from NZ Sugar are spasmodic and only meet a minor proportion of Agri-Feed's requirements.
22. In New Zealand, molasses is used principally as a supplementary feed in the dairy agricultural sector. Currently, sales to the agricultural sector account for about two thirds of total annual sales. Most sales of molasses are made in the North Island where the major part of dairy production in New Zealand is concentrated. Some molasses is also sold into the agricultural sector in the South Island, but the volumes are relatively small.
23. In relation to the agricultural sector, molasses has two major on-farm uses. First, the product is used primarily by dairy farmers in a diluted form as an energy supplement. Alternatively, molasses can be used as a masking agent for the purpose of administering medication to livestock, and to neutralise the high protein content of grass during the spring months.
24. The second major on-farm use for molasses is as an ingredient in the manufacture of dietary or health supplementary products for consumption by livestock. This involves combining molasses with vitamins and minerals to produce a range of products which are marketed under a variety of brand names.

25. The major outlets through which molasses is sold for on-farm use are stock and station agents, including Wrightson and Taranaki Farmers Co-op Ltd, and other rural trading companies, including Kiwi Trading Stores Ltd, a 100% owned subsidiary of Kiwi Co-operative Dairies Ltd, and Anchormart Ltd, a wholly owned subsidiary of The New Zealand Co-operative Dairy Company Ltd.
26. The other major use for molasses in the agricultural sector is as an ingredient for the production of compound stock feeds for consumption by calves and horses. Typically, molasses makes up about 10 to 15% of the content of such feed. The major producers of these manufactured stock feed products are NRM Feeds (“NRM”), PCL Industries Ltd (“PCL”), and Inghams Enterprises (NZ) Pty Ltd (“Inghams”). Molasses is delivered to stock feed mills by bulk liquid tankers.
27. Apart from sales to the agricultural sector, molasses is supplied to companies engaged in the manufacture of food products, or food ingredients. In New Zealand, yeast production accounts for the majority of sales of food grade molasses. Sales of molasses to end users in the food processing industry account for about one third of total consumption by volume.

Market Definition

28. Both Agri-Feeds and IML are engaged in the importation, storage, processing and distribution of bulk and drummed molasses for livestock consumption. Molasses is supplied to customers in a range of pack sizes, including 20kg pails, 250 kg drums, and is supplied in bulk liquid tanker delivered to on-farm storage tanks and to stock feed mills. In addition, Agri-Feeds supplies molasses to the food-processing sector.
29. The applicant submits that the market into which molasses is sold is a discretionary market, and involves farmers determining what type of feed that they will make available to livestock. Further, the applicant considers that farmers have many options available to them. These include:

- cutting pasture and conserving it as hay and silage;
 - planting supplementary crops for grazing (eg turnips, swedes and kale);
 - planting a supplementary crop for silage (eg maize);
 - purchasing grain, such as barley, oats, or maize; and
 - purchasing a compound stock feed.
30. In addition, the applicant notes that many farmers do not purchase molasses because there is a range of alternative products, including grass, hay, lucerne, silage, manufactured stock foods and other supplementary feeds which can be used in lieu of molasses.

Product Markets

31. For the reasons discussed above, molasses can be differentiated into two broad categories of end use: food industry and agricultural. Given that the only aggregation of activities resulting from this proposal arises in the agricultural sector we do not consider that it is necessary to examine the likely competitive impact in relation to the food-processing sector.
32. As noted previously, molasses has two principal end uses in the agricultural sector. The major end use is as a supplementary feedstuff, either in a diluted form, or as a dietary supplement. The other category in which molasses is used is in the form of an ingredient for the production of certain types of stock feed.
33. Staff enquiries have revealed that for on-farm use, molasses can be substituted by a range of animal feed products. In the event of a small, but non-significant increase in price (say 5%)¹, we believe that farmers could readily switch to other supplementary feed products. These might include grass-based feeds, such as hay or silage; grains, including maize, barley or oats; and other

¹ This is in accordance with the *ssnip* test which the Commission's *Business Acquisition Guidelines* advocates be used to provide the appropriate framework for testing substitutability, and hence for determining the boundaries of a market.

supplementary feed or dietary products as appropriate, such as animal lick products and liquid feed supplements.

34. In relation to the usage of molasses as input into stock feed manufacture, Agri-Feeds contends that stock feed mills have the option to use alternative products, such as corn syrup, or can reduce or eliminate molasses as a raw material in stock feed production. However, two large operators of stock feed mills have told staff that there are currently no viable economic alternatives for molasses when employed as input into the production of compound feeds. In addition, molasses accounts for only around 10 to 15% of the content of the final product, which means that a substantial price increase would be required to cause stock feed producers to consider switching to an alternative product.

Conclusion on Product Markets

35. It is concluded that the relevant product markets are supplementary livestock feed and molasses for use in the production of stock feed.

Function Markets

36. Staff consider that there are two functional levels which are relevant in the consideration of the proposed acquisition: the storage and distribution of supplementary livestock feed; and the importation, bulk storage and distribution of molasses for use in the production of stock feed.

Geographic Markets

37. Molasses is a relatively bulky and low value product. As a consequence, internal transport costs account for a relatively high proportion of the total cost of the product.
38. Our enquiries reveal that molasses is transported over a range of distances within the North and South Islands. IML distributes molasses from its bulk

storage facilities which are located at the port of New Plymouth to the Taranaki region and as far as Wanganui. Gardner Smith is currently distributing product from its Auckland bulk terminal facilities to the North Auckland, Waikato and Bay of Plenty regions.

39. Agri-Feeds is supplying molasses from its storage facilities at Mount Maunganui to most parts of the North Island. The major reason the company can transport molasses over relatively significant distances appears to be the large volumes which it supplies and the volumes purchased by various customers.
40. FIL purchases molasses from [] and distributes molasses throughout the South Island from its bulk storage facilities at the port of Timaru. The company also supplies a small amount of molasses to customers in the North Island.

Conclusion on Geographic Markets

41. Taking into account the above factors, staff consider that it is appropriate to define the relevant geographic markets for each of the product/function markets as the North Island.

Conclusion on Market Definition

42. In summary, we conclude that for the purpose of analysing the competition issues arising from the proposed acquisition the relevant markets are:
- the North Island market for the storage and distribution of supplementary livestock feed; and
 - the North Island market for the importation, bulk storage and distribution of molasses for use in the production of stock feed.
43. In the assessment of the market for supplementary livestock feed, we intend to include both dietary supplements and feed supplements as part of the same market.

DOMINANCE ASSESSMENT

Statutory Considerations

44. Section 66(3) of the Act, when read in conjunction with s 47(1) of the Act, requires the Commission to decline to give clearance to a proposed acquisition if it is not satisfied that the proposed acquisition would not result, or would not be likely to result in a person acquiring or strengthening a dominant position in a market.

Overview

45. The acquisition would result in some aggregation of market share in relation to the storage and distribution of molasses as a supplementary feed, and the storage and distribution of molasses for use in the production of stock feed. There would also be a strengthening of existing vertical integration between these markets and the markets for the manufacture of stock feed and the retailing of merchandise to the farming community.

Assessment of Dominance in the Supplementary Livestock Feed Market

46. Implementation of the proposed acquisition would result in some aggregation of market share in relation to the storage and distribution of molasses as a supplementary stock feed. Specifically, the proposal would have the effect of combining the activities of two of the suppliers of molasses to the dairy agricultural and stock and station sectors in the North Island. However, some competition is likely to be provided by Gardner Smith, which has commenced importing molasses over the past two years into its Auckland bulk storage facilities and distributing the product to customers in the upper North Island.

47. On the basis of enquiries with interested parties, there do not appear to be any difficulties associated with the importation of molasses, and while the establishment of storage tanks may require an outlay of about [] there are existing storage facilities at certain ports which are suitable for the bulk storage of molasses. For example, several parties whom staff spoke to, indicated that they have investigated the possibility of importing product from Australia and elsewhere, and consider that it would be feasible to do so directly, or through a commodity trader such as Gardner Smith.

48. As noted above, molasses constitutes only one product which farmers can use as a supplementary livestock feedstuff or dietary supplement for livestock. For instance, farmers can and do switch with relative ease to a variety of other feed products, including hay and silage; grains, including maize and barley; animal lick products; and other feed supplements. If Agri-Feeds were to raise its prices, or to reduce the quality of its service, it would be relatively straightforward for farmers to change to an alternative supplementary feed product. This could be achieved by farmers purchasing from an external source (eg buying maize, barley or a manufactured stock feed), or making the necessary arrangements to produce a supplementary feed themselves (eg planting a crop or cutting grass and converting it into hay or silage).

Conclusion on Dominance in the Supplementary Livestock Feed Market

49. Given the constraint from Gardner Smith, the potential to import molasses, and the wide range of alternative supplementary feed products, staff conclude that the combined entity would not be likely to acquire or strengthen a dominant position in the supplementary livestock feed market.

Assessment of Dominance in the Market for the Importation, Bulk Storage and Distribution of Molasses for Stock Feed Production

Overview

50. Agri-Feeds is the principal supplier of molasses in the North Island for use as an ingredient in stock feed manufacture. The company distributes the product from its Mount Maunganui site to various mills situated in the North Island, including to []. IML is a substantially smaller player in this market, and its activities have been confined to providing product to smaller feed mills in the Taranaki/Wanganui area.
51. The only other current participant in this market is Gardner Smith, which has been importing molasses into Auckland over the last two years for distribution to feed mills in the upper North Island. So far, Gardner Smith has imported only a relatively small volume of molasses for supply to feed mills.

Market Shares

52. Estimated market shares for the supply of molasses to stock feed mills are provided in Table 1 below.

Table 1
Approximate Market Shares Based on Tonnage

	Tonnes (Approx)	% (Approx)
Agri-Feeds	[]	[]
IML	[]	[]
	[]	[]
Gardner Smith	[]	[]
	[]	100

Entry/Expansion Conditions

53. Molasses is an internationally traded commodity. Australia is a global producer of molasses and provides a convenient and accessible source of supply for New Zealand importers of the product. Molasses can also be imported from Fiji and various Asian countries. While some product is available from NZ Sugar, the quantities are relatively small and fluctuate quite significantly.
54. There are no tariffs or other major obstacles associated with the importation of the product. However, when importing molasses in bulk tankers it would be necessary to meet minimum purchase levels of 1-2,000 tonnes. Alternatively, there appears to be some scope for small end users to import molasses in drums or pillows carried in shipping containers.
55. As noted previously, Gardner Smith is already importing molasses, and has bulk storage facilities at Auckland which are suitable for handling molasses. Given the physical characteristics of molasses it is necessary to store the product in tanks which can be heated. Gardner Smith has the appropriate handling facilities at its Auckland site.

Countervailing Power of End Users

56. The distribution of molasses for use as an input in the manufacture of stock feeds is confined largely to a limited number of large purchasers, including NRM, and to a lesser extent, PCL and Inghams, with a large number of small feed mills accounting for the balance of sales. NRM, which is 100% owned by Heinz-Watties Ltd, is a company with the necessary resources to impose a major discipline on an enlarged Agri-Feeds.
57. For these reasons, staff consider that the combined entity is likely to be constrained to some degree by the countervailing power of large customers in this market.

Conclusion on Dominance in the Market for the Importation, Bulk Storage and Distribution of Molasses for Stock Feed Production

58. If the proposed acquisition proceeds, Agri-Feeds would increase its market share in relation to the importation, bulk storage and distribution of molasses for use in stock feed production from about [] to around []. However, staff are of the view that the combined entity would be constrained by the actual and potential threat of competition. In particular, Gardner Smith has established a presence in this market, albeit in a relatively limited form. Gardner Smith also has the expertise in commodity trading, and has the storage facilities to expand its presence in this market, if the enlarged Agri-Feeds were to attempt to exercise any undue market power. Staff have identified no major obstacles to Gardner Smith increasing its existing market share. For example, there are no tariffs and the product is readily available from a number of overseas sources, although minimum tonnage requirements apply.
59. In addition to the constraint from Gardner Smith, we consider that some of the large end users are capable of providing some countervailing market power in their capacity as large-scale purchasers of molasses.

Conclusion on Dominance

60. In view of these factors, staff consider that the constraint provided by Gardner Smith and the countervailing power of large customers would be sufficient to prevent the combined entity from acquiring or strengthening a dominant position in the market for the importation, bulk storage and distribution of molasses for use in the production of stock feed.

Vertical Integration

61. As noted previously, Agri-Feeds (and its interconnected bodies corporate), have interests in a wide range of activities associated with the production and distribution of farm products, including manufactured stock feed and supplementary livestock feed. IML's interests are confined to the supply of bulk and drummed molasses for use as a stock feed supplement in the Taranaki region. The company is also engaged in the distribution of molasses to Agricorp, which is owned by one of the shareholders of IML. Agricorp uses molasses as an ingredient in the production of feed supplements.
62. The acquisition would lead to a strengthening of existing vertical integration between various markets relating to the manufacture, importation, storage and merchandising of stock feeds and supplementary livestock feed. However, these markets are competitive, and are likely to remain so post-acquisition. Further, it is our view that the acquisition is unlikely to raise entry barriers to such a level as to cause dominance concerns.

Conclusion on Vertical Integration

63. In these circumstances, we conclude that the strengthening of vertical integration which would result from the proposed acquisition would not lead to dominance being acquired or strengthened in a market.

OVERALL CONCLUSION

64. Having regard to the factors outlined above, staff conclude that implementation of 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.

RECOMMENDATION

65. It is recommended that in terms of s 66(3)(a) of the Act, and in accordance with a delegation granted under s 105 of the Act, the Commission gives clearance for the proposed acquisition.

Susan Bowler
Projects' Officer

Jeff Hamilton
Investigator

Jo Bransgrove
Manager

DETERMINATION ON NOTICE OF CLEARANCE

AGRI-FEEDS LIMITED/INDEPENDENT MOLASSES LIMITED

I agree/disagree with the recommendation.

I am satisfied/not satisfied that implementation of the proposal would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

Accordingly, pursuant to s 66(3) of the Commerce Act 1986, and in accordance with a delegation granted under s 105 of the Act, I hereby give/decline to give clearance for the acquisition by Agri-Feeds Limited of all stocks of, and the customer list for, molasses from Independent Molasses Limited.

Dated this day of July 1998

Kate Brown
Member