



COMMERCE COMMISSION

Statement of Preliminary Issues

AsureQuality / Proficiency Services Limited

22 October 2010

INTRODUCTION

1. On 15 October 2010, the Commerce Commission received an application from AsureQuality and Proficiency Services Limited seeking clearance to form a new joint venture company. The joint venture company would acquire all of the laboratory proficiency testing business assets of AsureQuality and Proficiency Services Limited.
2. Proficiency testing is the quality assessment of individual laboratories' services. Each of a number of laboratories submits their results from tests on a standard identical sample supplied by a proficiency tester. The capability of each laboratory is determined by its variance (if any) from the norm of the total of the test results of the laboratories tested. This analysis is carried out by the proficiency tester.
3. The clearance application relates to both parties' provision of these services to a number of laboratories involved, most importantly, in the meat, dairy and milk industries.
4. The public version of the application can be accessed on the Commission's website at:
<http://www.comcom.govt.nz/clearances-register/detail/696>
5. This Statement of Preliminary Issues outlines the competition issues the Commission currently considers will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for clearance progresses.
6. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger.

RELEVANT PARTIES

7. AsureQuality is a state owned enterprise that provides proficiency testing services, food safety and biosecurity services to the food and primary production sectors.
8. Proficiency Services also provides proficiency testing services, as well as laboratory reference materials and related services.

ANALYTICAL FRAMEWORK

9. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. The first step of the Commission's analytical framework¹ is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the proposed acquisition. The Commission then considers the relevant products and geographic regions that constitute close substitutes from both a customer's and a supplier's point of view.
10. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:
- with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).

The impact of the acquisition on competition is then viewed as the prospective difference between those two scenarios.

11. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:
- existing competition - the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices;
 - potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so;
 - the countervailing market power of buyers - the potential for a business to be sufficiently constrained by purchasers' ability to exert an influence on price, quality and/or terms of supply; and
 - coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
12. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition may lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

PRELIMINARY ISSUES

13. Of the factors outlined in the previous section, the Commission currently considers its focus in respect of the proposed acquisition will be on the following areas:

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

Markets

14. The Applicants have submitted that their application should be analysed in terms of tender markets where competition occurs at the time of the tender for the whole market. Thus tenders may be organised by participants in each of the meat, dairy and milk industries for the proficiency testing of laboratories servicing those industries.
15. The Commission will test whether a tender market structure is the correct method to analyse the application.

Potential Competition

16. The applicants have advised that AsureQuality and Proficiency Services are currently the two main active participants in proficiency testing markets in New Zealand. The applicants have submitted that certain near competitors together with the potential for new entry would place a competitive constraint on the combined entity.
17. The Commission will test whether near competitors and/or potential entry into the proficiency testing markets would be likely, of sufficient extent and timely enough to constrain the combined entity if it sought to increase prices post acquisition, given the considerable aggregation of market share arising.

Countervailing power

18. The Commission will assess whether any of the main proficiency testing customers will be able to exercise any countervailing power against the combined entity through the threat of switching or any other mechanism such as refusal to roll-over existing contracts at their term end.

NEXT STEPS

19. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at www.comcom.govt.nz), the Commission has established a draft timeframe for consideration of the application for clearance. An extension of time was agreed to by the Applicant such that the Commission should make its final decision by **13 December 2010**. However, also in line with the Merger and Acquisitions Clearance Process Guidelines, this timeframe could change. To keep abreast of possible changes in relation to timing and to find relevant documents, visit the Clearance Public Register on the Commission's website at:

<http://www.comcom.govt.nz/clearances-register/>

20. As part of its investigation, the Commission will identify the parties it believes will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks.
21. The Commission also invites submissions from any other parties who consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference AsureQuality / Proficiency Services in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by **5pm on Friday 19 November 2010**. Please clearly identify any confidential information contained in the submission and provide contact details.