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COMMERCE COMMISSION

Decision No. 441

Determination pursuant to the Commerce Act 1986 in the matter of an application for Clearance involving:

CANTERBURY MEAT PACKERS LIMITED

and

PHOENIX MEAT COMPANY LIMITED

The Commission: J M Belgrave
P R Rebstock
P J M Taylor

Commission Staff:

Summary of Application: The business acquisition by Canterbury Meat Packers Limited or one of its interconnected bodies corporate of up to 100% of the shares in or assets of Phoenix Meat Company Limited and/or any of its interconnected bodies corporate.

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

Date of Determination: 31 August 2001

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THE PROPOSAL

1. On 10 August 2001, the Commerce Commission ("the Commission") registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act"), in which clearance was sought by Canterbury Meat Packers Limited or one of its interconnected bodies corporate ("CMP") for the acquisition of up to 100% of the shares in or assets of Phoenix Meat Company Limited and/or any of its interconnected bodies corporate ("Phoenix").

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 notice agree to a longer period. A one week extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 31 August 2001.

3. In its application, CMP sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's determination is based on an investigation conducted by staff.

5. The Commission's approach is based on the principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

Canterbury Meat Packers Limited

6. CMP is a meat processing company operating plants in Seafield (Canterbury) and Riverlands (Marlborough). CMP is jointly owned by Asian New Zealand Meat Company Limited (80%), a wholly-owned subsidiary of ANZCO Foods Limited ("ANZCO"), and Phoenix (20%) (which is the target of the proposed acquisition).

7. CMP was incorporated in August 1994, and entered the market through purchasing the Seafield plant following the collapse of Fortex. This plant was used to establish a sheep meat business. CMP subsequently constructed a beef processing plant on the Seafield site.

8. CMP's activities are described in the application as being the "…processing, marketing and exporting of sheep meat, beef, and related products". CMP sells some product to wholesalers but the meat it processes is mainly destined for the export market.

9. For the 1999/2000 year CMP had a turnover of [ ].

10. CMP's beef plant was purpose-built to process stock from Five Star Beef ("FSB"), which is a 50/50 joint venture between Itoham, and ANZCO (major shareholder in CMP). FSB purchases cattle as stores and finishes the cattle on grain for a period of 3-

[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

9 months. This produces a very high quality beef, which is sold to the Japanese market. The processing requirements for FSB amount to around [ ] head per year.

Phoenix Meat Company Limited

11. Phoenix is a meat processing company operating a beef plant in Koriri, Greymouth. As well as the processing plant, Phoenix also operates a domestic wholesale and retail operation. This is called Westmeat New Zealand Limited and includes a wholesale operation at Hokitika, and retail outlets in Nelson, Blenheim, Greymouth and Richmond, and a presence in Christchurch.

12. Phoenix only processes beef so the Commission's enquiries have concentrated on the appropriate beef markets.

13. For the 1999/2000 year Phoenix had a turnover of [ ].

OTHER RELEVANT PARTIES

Alliance Group Limited

14. Alliance Group Limited ("Alliance"), based in Invercargill, is a co-operative company owned by more than 7,500 farmers. These farmers supply livestock to the company for processing and sale of the resulting meat and co-products. Around 95% of the company's products are exported.

15. Alliance currently operates two beef plants, one in Mataura (Southland) and the other in Pukeuri (near Oamaru). It is also planning to re-open its Sockburn (Christchurch) plant next year.

16. For the 1999/2000 year Alliance had a turnover of [ ].

Primary Producers Co-operative Society Limited

17. Primary Producers Co-operative Society Limited ("PPCS"), based in Dunedin, is a co-operative company that processes and sells meat. PPCS currently operates two beef plants; one in Belfast (Christchurch) and one in Finegand (Southland). [ ]

18. For the 1999/2000 year PPCS had a turnover of [ ].

Local Operators

Malvern Abattoirs/Ashburton Meat Processing

19. Malvern Abattoirs and Ashburton Meat Processing are under the same ownership. They are both based in Canterbury and supply processed beef and sheep to supermarket chains and other wholesalers.

ABCO Meats/Bay City Meats

20. Bay City Meats is a wholly-owned subsidiary of ABCO Meats. Bay City Meats is based in Timaru, while ABCO is based in Oamaru.

Prime Range Meats

21. Prime Range Meats is a meat processor based in Invercargill.

Blenheim Master Butchers

22. Blenheim Master Butchers is a meat processor based in Blenheim.

INDUSTRY BACKGROUND

Meat Industry

International Markets

23. For the year ending June 2000 sales of lamb, beef and mutton meat and co-products exceeded $4 billion.[2] This made meat New Zealand's second largest export earner after dairy products. Around 90% of lamb produced in New Zealand is exported, while the equivalent figure for beef is 80%. New Zealand is the world's largest exporter of lamb, and the fourth largest exporter of beef.

24. New Zealand beef is exported to over 100 countries. USA is the main export destination for New Zealand beef, accounting for around 64% of sales (in terms of tonnage for the year ending September 2000).[3] Most of the products sent to the USA is referred to as "manufacturing" or "grinding" beef because it is low quality meat to be used predominantly in hamburgers. The second biggest export destination is Asia, accounting for around 18% of sales. The product-mix sent to Asia contains a much higher proportion of high value cuts, so the proportion of sales by value to Asia is around 25%. Other export destinations of significance are Canada (10%), the Pacific (2.6%), and Europe (1.6%).

25. Beef is largely a commodity product so demand and prices at the international level are cyclical. However, the final returns to farmers are strongly influenced by the exchange rates. The unpredictability of the exchange rate and the presence of some short-term rigidity in supply mean the market can be quite volatile. The meat processors have advised the Commission that they operate "on the basis of margins" (rather than revenues) so it is the farmer that is most affected by these fluctuations in the market. At present exchange rates are very favourable to New Zealand farmers so returns are high.

Supply of Beef

26. The beef processing industry is supplied by beef and dairy cattle. Overall livestock trends are driven by international beef prices, as well as other factors. Beef cattle numbers are likely to be driven by prices paid by processors, which in turn are driven largely by world prices. However, dairy cattle numbers are determined by market conditions in dairy product markets. New Zealand has recently experienced a "boom" in the dairy industry that has dramatically increased the number of dairy cattle. The expansion of dairying is particularly great in the South Island where numbers have approximately tripled in the last ten years to around 956,000. During the same period beef cattle numbers increased by around 50% in the South Island. By comparison beef and dairy cattle numbers have remained relatively static in the North Island, where the majority of stock resides. Table 1 below shows the stock numbers in the respective areas throughout New Zealand.

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[2] "The Business of New Zealand Meat", Meat New Zealand, July 2001.
[3] Meat New Zealand Annual Report, Meat New Zealand, 1999-2000.

Table 1:
Cattle Numbers by Type and Region as at June 2001

Region	Beef Cattle		Dairy Cattle	
	Number (000s)	*% of total*	*Number (000s)*	*% of total*
Northland/Waikato /BOP	1684	34	2389	54
East Coast	1284	26	247	6
Taranaki/Manawatu	598	12	853	19
Canterbury/Westland	854	17	581	13
Otago/Southland	486	10	375	8
Total	4906	99	4445	100

Source: "The Business of New Zealand Meat", Meat New Zealand, July 2001

27. The rise in dairy cattle has come mainly at the expense of sheep farming. Sheep numbers have fallen consistently since 1990. In 1990 there were around 58 million sheep in New Zealand, but now there are only around 45 million. The large increase in dairy cattle numbers has had a significant affect on meat processing. Many South Island beef processing firms are expanding their operations in anticipation of the increased numbers of cull cows supplied for processing.

Meat Slaughter and Processing

28. A characteristic of the meat processing industry is its seasonal nature. A profile of the processing year would show that production is quite flat for most of the year, with a peak in autumn when the cull cows from the dairy industry come in for slaughter. To cope with the peak, processing companies require large capacities that are largely under-utilised for most of the year. The length and intensity of the peak are strongly influenced by availability of grass – when grass is available farmers usually choose to hold onto stock, but if grass is in short supply farmers will seek to off-load stock as soon as possible. The North Island generally has better weather so the culling season lasts longer than in the South Island.

29. The periods on either side of the peak are referred to as the "shoulder" periods. During these periods the marginal cost of killing is below the average cost and the companies will actively seek stock to maximise throughput.[4] Farmers get the best price for their stock during the shoulder periods.

Previous Investigations

30. The meat industry has been considered on several occasions in the recent past. Below is a non-exhaustive list of recent adjudication cases and a brief summary of their outcome. In these cases, the Commission assessed the acquisition under the former dominance test. The current proposed acquisition has been considered under the substantial lessening of competition test, as specified in the recent amendment to the Commerce Act.

Richmond Limited/Waitotara Meat Company Limited

Decision 371, 6 September 1999 (Clearance Application)

[4] *See* "The Structure and Dynamics of New Zealand Industries", Chapter 2: Red Meat, CW Maughan

31. Relevant markets were defined as those for “the procurement of sheep and lambs for slaughter and processing in the North Island”, “for the wholesale supply of meat products in New Zealand”, and “the supply of fellmongery services in the North Island”.

32. The Commission found that the merged entity’s market share would fall within the safe harbours in all of the above markets. The Commission was of the view that the merged entity would by constrained by existing competition and the threat of new entry.

Richmond Limited/Lowe Walker NZ Limited

Decision 316, 11 February 1998 (Clearance Application)

33. Relevant markets were defined as those for “the procurement of sheep and lambs for slaughter and processing in the North Island”, “the procurement of beef for slaughter and processing in the North Island”, “the processing of meat by-products”, and the “ wholesale supply of meat products in New Zealand”.

34. The Commission found the merged entity’s market share fell within the safe harbours in all markets. The Commission concluded that the merged entity would be constrained by actual and potential competition.

Weddel New Zealand Limited

Decision 273, 2 February 1995 (Authorisation Application)

35. Relevant markets were defined as those for “the procurement of sheep and lambs for slaughter and processing in the North Island” and “the procurement of beef for slaughter and processing in the North Island”.

36. A consortium of North Island meat processing companies applied for authorisation to the collective acquisition and closure of certain meat processing plants owned by Weddel (which was in receivership and liquidation). The Commission determined that the public benefits of the arrangement exceeded the public detriments from the loss of competition and granted authorisation.

Price Fixing Case 1995

37. The Commission brought proceedings against several North Island meat companies in October 1995 alleging that they fixed prices for procurement of stock between October 1992 and April 1995. The allegations were upheld by the High Court and Court of Appeal, resulting in penalties totalling $5.510 million.

MARKET DEFINITION

38. The Act defines a **market** as:

> *. . . 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.*

39. For the purpose of competition analysis, a relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, could impose at least a <u>s</u>mall yet <u>s</u>ignificant and <u>n</u>on-

transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year. Note that when the Commission considers the potential market power on the buyers side of the market, as in this case, the corresponding consideration is a small yet significant *decrease* in price.

40. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

41. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

    ?? the goods or services supplied and purchased (the product dimension);

    ?? the level in the production or distribution chain (the functional level);

    ?? the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and

    ?? the temporal dimension of the market, if relevant (the timeframe).

42. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

43. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

44. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those products on the supply-side.

45. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[5] The

[5] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 351 Smellie J and the Court of Appeal on appeal cite with approval an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a

Commission considers this to be a period of one year, which is the period customarily used internationally in applying the ‘ssnip’ test[6] to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

46. The applicant submits that four markets will be affected by this acquisition:

    ?? The market for the procurement of beef for slaughter and processing in the South Island.

    ?? The market for processed beef meat and beef meat products for export.

    ?? The market for the wholesale supply of beef meat products and co-products in New Zealand.

    ?? The market for the retail of beef meat products and co-products in New Zealand.

47. 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 processed beef meat and beef meat products for export is not a market in New Zealand, it will not be considered further in this analysis.

48. The applicant has submitted that because of the low market share of the combined entity and competition from other meat sources, the wholesale and retail functional levels will not be materially affected by the acquisition. The Commission accepts this view and will not consider these markets further.

49. Consequently, the market for the procurement of beef for slaughter and processing in the South Island is the only potential market that will be considered in depth by the Commission.

Demand-side substitution

50. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

51. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

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field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive”. See also *News Limited v*
[6] *Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: “Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation.” Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

52. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

Supply-side substitution

53. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in their relative prices.

54. In this case, where the concerns lie with potential power on the buyers' side of the market, supply-side substitutability is particularly relevant. There are limits to supply side substitution in this market. The Commission has previously found that separate product markets exist for beef, and for sheep and lambs. Farmers would not send their cattle to sheep works or vice versa. The Commission also found that meat works were quite specialised in the animals they could handle and could not switch production quickly or at low cost.

Undifferentiated/Differentiated Products

55. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

56. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

57. The term "beef" used in this report encompasses grain-fed beef, grass-fed beef, steers, heifers, bulls and dairy cows. Some differentiation of product does occur, as a grain-fed animal is of higher quality and greater value than a dairy cow, the meat of which is mostly sent to the USA for hamburgers. Furthermore, the average carcass weight of animals sold on the domestic market is lower than for those sold on export markets. However, for the purpose of this application, separate product markets for particular types of animals will not be defined. Meat processors are equally able to process either kind of animal and are indifferent between the two types.

58. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is the market for the procurement of beef for slaughter and processing .

Geographic Extent

59. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

60. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

61. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

62. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

North Island and South Island markets

63. The applicant refers to the Weddel Decision, which authorised the acquisition and closing of the Weddel processing plants by a consortium of meat processing companies. In that decision, the Commission found that the North Island and the South Island were separate markets for the procurement of beef for slaughter and processing.

64. However, the applicant underlines that the situation has changed since the time of that earlier decision, and that the South Island "market boundary is permeable".

65. The estimated number of beef cattle transferred from the South Island to the North Island for export slaughter in 2000/2001 is [ ].[6] This only accounts for [ ]% of the total number of beef cattle slaughtered for export in New Zealand ([ ] head), which is not significant.

66. Furthermore, there was no such inter-Island transfer during the previous two years. The flow in 2000/2001 was understood to reflect exceptional weather conditions – a drought that affected the South Island last year and led farmers to increase their dairy cull for slaughter, at a time when capacity in the South Island was stretched. In general, market participants have advised that sourcing cattle from the other Island is considered as being an option, but only as a response to exceptional market conditions.

[6] Source: Meat and Wool Economic Service of New Zealand.

67. The Commission will adopt a conservative approach, consistent with past investigations. For the purpose of this application, the Commission will consider separate markets for the procurement of beef for slaughter and processing in the North Island and in the South Island.

68. The movement of stock is a dynamic phenomenon, reflecting availability of stock, price, transport costs, and the desire to maximise the throughput in meat works. The slaughter and processing plants have identifiable catchment areas from which they draw livestock, but these areas overlap with no clear boundaries. There is significant movement of stock throughout the South Island. All market participants have advised that they consider all areas in the South Island as potential sources of stock for slaughter.

69. On the basis of the above discussion, the Commission concludes the geographic market that should be used for the purpose of the competition analysis is for the South Island.

Functional Level

70. The production, distribution and sale of a product typically occurs through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[7] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, 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.

71. The relevant functional level is the purchase of beef cattle for slaughter and processing.

The Timeframe

72. Generally, the Commission will view markets as functioning continuously over time. However, where a market is characterised by, for example, infrequent transactions, the Commission may seek to define a separate time dimension as part of its market definition process. Time considerations are also important where there are long-term contracts, and where there are depletable resources.

73. Time dimension is not relevant to the market for the procurement of beef for slaughter and processing as transactions are small and frequent, there are few long-term contracts between purchasers and sellers, and the resource is not depletable. However, the impact of the acquisition on competition during peak periods will be considered in the competition analysis.

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[7] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

Conclusion on Market Definition

74. The Commission concludes that the relevant market is the market for the procurement of beef for slaughter and processing in the South Island.

COMPETITION ANALYSIS

Substantially Lessening Competition

75. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> *A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.*

76. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[8] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance as to make it worthy of consideration.[9]

77. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[10]

78. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

?? the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);

?? the nature and extent of the contemplated lessening; and

?? whether the contemplated lessening is substantial.[11]

79. In considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

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[8] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).
[9] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.
[10] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.
[11] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

80. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

81. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

82. The Applicant submits that:

> "Phoenix's competitive position is restricted to some extent by the level of efficiencies that can be achieved from its relatively modest operating base and limited geographic catchment for stock procurement. Although Phoenix's Kokiri plant has ample annual capacity, the company is seldom able to maximise throughput. As a consequence the Company is not able to generate economies of scale to the same extent which may be available to its competitors."

83. The Applicant also submits that:

> "if the proposed acquisition were not to proceed, then the most likely scenario over the next two years would be the gradual decline by Phoenix while Alliance, PPCS and CMP increased production in response to the increase in supply driven by the dairy boom."

84. The Commission understands that traditional supplier loyalty is diminishing, especially on the West Coast, partly as a consequence of the ongoing changes in land-use and the increasing shift towards dairying operations. The recent confirmation by Alliance of the re-commissioning of its Sockburn beef processing plant in Christchurch is likely to place additional pressure upon Phoenix in regard to the procurement of livestock on the East of the South Island. On-going road improvements would further increase Phoenix's exposure to South Island competitors.

85. Phoenix management believes that procurement competition from Alliance Sockburn will limit the increased throughput Phoenix might otherwise have expected on the back of the dairy boom. As a result, the management of Phoenix believes that processing volumes for the firm will remain at best static.

86. The Commission considers that the short-term viability of Phoenix is not at stake, for the following reasons:

?? Kokiri is a relatively modern plant, certified USDA[12], EU[13] and Halal standards, ISO 9002 and incorporating relevant HACCP[14] principles.

?? In 2001, the Company has invested approximately [ ] to upgrade the slaughterhouse operation, plus [ ] to support the rendering activity, calf processing and domestic trade expansion, the need for which arose following the closure of the Nelson Bays beef plant (which was jointly owned by Phoenix and Alliance). In the 2000 annual report, the Managing Director notes [ ].

?? The road improvements between the West Coast and the East will allow Phoenix to source livestock more easily and at lower cost from the East.

?? The Phoenix annual kill number for beef has increased from [ ] head in 2000 to [ ] head in 2001 (estimated). This increase was driven by two factors:

✍✍the closure of the Nelson Bays beef plant; and,

✍✍the ownership initiative undertaken by Phoenix to raise its own cattle for slaughter during the shoulders of the season, when additional throughput is most sought after. In the year ended 30 September 2000, approximately [ ] of Phoenix production related to company-owned stock.

87. [ ]

88. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios, should a merger not proceed.[15]

89. The Commission considers that the status quo is the most appropriate approximation for the counterfactual given the following considerations:

?? Even though it is possible Phoenix will face more pressure in regard to the procurement of livestock, its plant is modern and its survival doesn't seem to be at stake.

?? [ ]

The Commission therefore proposes to use the status quo as the counterfactual.

Potential Sources of Market Power

90. Two types of market situation conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between

[12] United States Department of Agriculture.
[13] European Union.
[14] Hazard Analysis and Critical Control Point.
[15] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

91. In undifferentiated product markets, buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition. A business acquisition may have the potential to substantially lessen competition in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one year time frame.[16] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

92. In differentiated products markets, where the product offerings of different firms vary, and in which buyers make their purchase decisions on the basis of product characteristics as well as of price, the products of firms are by definition not perfect substitutes for each other. The substitutability between products will vary depending upon differences in their various characteristics, which may include their physical specifications, brand image, associated services and location of sale. In simple terms, differentiated products can be thought of as being arranged in a "chain of substitutes", where those in adjacent positions in the chain tend to be close substitutes, and those positioned further apart are less close substitutes.

93. The supply-side characteristics of differentiated products markets are important, as the potential market power of the combined entity may be offset by the actions of rivals. However, rivals may not be able to offer a competitive constraint where they are unable either to re-position their products closer to that of the combined entity to replace the lost localised competition, or to strengthen the promotion of existing products. A further possible constraint would be lost if it were not possible for new products to be added through new entry.

94. The Commission considers that in the present application, the product is not so differentiated as either to cast doubt on there being a single, well-defined, market for the procurement of beef for slaughter and processing in the South Island, or to require a special analysis with fully differentiated product markets.

Conclusion – Competition Analysis Principles

95. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of the acquisition. In the present case the counterfactual is considered to be the status quo. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

96. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity.

[16] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

The balance of this Decision considers and evaluates the constraints that might apply in the beef procurement market under the following headings:

?? existing competition;

?? potential competition from entry; and

?? other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

97. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

98. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

99. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[17]

100. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm relationships, and the level of imports. This is followed by an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

[17] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

Existing Participants

101. In the market for the procurement of beef for slaughter and processing in the South Island, the existing participants fall into two categories:

?? the exporting companies: Alliance, PPCS, Canterbury Meat Packers and Phoenix.

?? the local trade companies: Blenheim Master Butchers, Malvern Abattoir (Christchurch), Ashburton Meat processors, ABCO (Omaru), Bay City Meats (Timaru, a fully-owned subsidiary of ABCO) and Prime Range Meats (Invercargill).

102. Local trade operators purchase and process stock for the domestic market. They are competitors in the market because they compete for the same cattle as export companies. Because of this competition, domestic prices are mainly determined by the export market. Recently, as opportunities from exporting have grown in comparison to domestic markets, many local operators have sought export licences. For example, Malvern Abattoir is looking to obtain an export license and [ ].

Inter-firm Relationships

103. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

104. The Commission understands that there are no formal or other relationships between CMP, Alliance and PPCS. An arrangement that existed between Phoenix and Alliance for the procurement of beef and sheep meat in the Nelson area will end with the acquisition. Phoenix currently holds 20% of the shares in CMP.

105. With regard to local trade operators, Malvern Abattoirs and Ashburton Meat processors are jointly-owned and Bay City Meats is a wholly-owned subsidiary of ABCO.

Imports

106. In markets where imports are present, the Commission will consider whether actual competition from imported products is the equivalent to that from domestic supply. In undertaking this evaluation, the Commission will take into account the existence of any limits on quantities of imported product (the price elasticity of supply), and the effects on trade of various factors. Imports channelled through the parties to an acquisition, or persons associated with them, will be added to their domestic production in assessing market share, rather than being treated as independent sources of supply.

107. Potential imports may also provide a constraint on domestic suppliers. This is considered as part of the assessment of the constraint from market entry below.

108. There is no import of livestock in New Zealand.

Safe Harbours

109. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission's 'safe harbours' can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

?? where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or

?? where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

110. Market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

Market Shares

111. Capacity figures for particular plants can be misleading, in that they are calculated on the basis of a static view of the business operation. The figures are calculated on the basis of a set number of shifts operating for a set number of kill days. However, any extrapolation of these figures over an annual period has little meaning, given there is not an even supply of stock throughout the year. The throughput triples during the peak season, with night shifts and seasonal workers being added.

112. Given the above limitations on using plant capacity as a measure, the Commission proposes to use the number of head killed per year as its primary measure of market share and concentration. The resulting shares are shown in Table 2 below. The Commission has also considered capacities to check that any market power the merged entity may have is not heightened during peak processing periods.

Table 2:

Estimated Market Share for the South Island Market for the Procurement of Beef for Slaughter and Processing

	Estimated 2000/2001	**Market Share**
Export		
Alliance Mataura Pukeuri	 [ ] [ ]	 [ ]
PPCS Belfast Balclutha (Finegand) Gore	[ ]	[ ]
CMP Marlborough Canterbury	 [ ] [ ]	 [ ]
Phoenix Kokiri	 [ ]	 [ ]
Merged Entity		**[ ]**
Total Export	*[ ]*	*[ ]*
Local		
Blenheim Master Butchers	[ ]	[ ]
Malvern Abattoirs Ashburton Meat Processors	[ ] [ ]	 [ ]
Bay City Meats (Timaru) ABCO (Oamaru)	[ ] [ ]	 [ ]
Prime Range Meats (Invercargill)	[ ]	[ ]
Total Local	[ ]	*[ ]*
Total S.I.	**[ ]**	**[ ]**

113. The merged entity would have [ ] of the market share, with a three firm concentration ratio of [ ]. These percentages fall outside the Commission's second safe harbour given above.

114. As noted above, market shares are insufficient in themselves to establish whether competition in a market has been lessened. The other competition factors noted above are considered in subsequent sections for the relevant market.

State of Existing Competition

115. The acquisition would result in the merged entity becoming the biggest beef slaughter and processing company in the South Island. Despite this, the merged entity would face strong competition from PPCS and Alliance as well as local suppliers. The expanding export market has given both export and local competitors the confidence to expand their operations.

116. With [ ]% of the market share, PPCS would be the second largest player in the market after the merger. [ ]. It is anticipating slaughtering around [ ] beef head for the coming year.

117. Alliance has around [ ]% of the market, which would make it the third largest in the market post-merger. In addition to its current capacity it is planning [ ] expansion over the coming year. It plans to re-open its Sockburn plant near Christchurch, [ ]. It also introduced new shift arrangements at its Mataura plant last year. Alliance expects its throughput to reach [ ] head next year, and then further increase the following year, once all the new processing operations and arrangements have been implemented and tested.

118. Local operators are also likely to place considerable competitive constraint on the merged entity. As the domestic market is ultimately limited, all local operators are in the process of either expanding their facilities, up-grading to export standard, or applying for an export licence.

?? Blenheim Master Butchers is [ ].

?? Malvern Abattoirs and Ashburton Meat Processors have [ ]

?? Prime Range Meat [ ].

119. Competition is therefore strong and increasing, with export competitors expanding their capacity, and local companies up-grading and applying for export licences. This will increase the competitive constraint imposed upon the combined entity.

Capacities during Peak Periods

120. As well as market share based on cattle numbers slaughtered (see table 2 above) the Commission has also checked market share on the basis of capacity to ensure that the merged entity will not have significantly more market power during peak periods compared to that indicated by its market share in Table 2. The daily capacities indicated below are based on estimates provided by the market participants, and includes expansion planned but not yet undertaken by the participants. It is recognised that the capacities are not precise, as capacity can be altered by increasing the number of shifts and making adjustments to (say) chiller numbers. However, the Table is useful as an indicator.

121. The Table indicates that the merged entity will have [ ]. The Table below does not include local operators. However, it can be seen that once all the market participants are included, the market shares on the basis of capacity are likely to be close to or less than those based on cattle numbers.

Table 3:
Approximate Capacity of Export Companies for 2001/2002 Season

Export companies	Capacity per day per plant (number of head killed)	Total	Market Share
Alliance			
Mataura	[ ]		
Pukeuri	[ ]	[ ]	[ ]
Sockburn	[ ]		
PPCS			
Belfast	[ ]		
Balclutha (Finegand)	[ ]	[ ]	[ ]
CMP			
Marlborough	[ ]		
Canterbury	[ ]	[ ]	[ ]
Phoenix			
Kokiri	[ ]		
Total	[ ]	[ ]	[ ]

* [ ]

Conclusions – Unilateral Market Power

122. The merged entity will be constrained by current competition. The increase in capacity of the biggest competitors, and most of the small competitors, will increase the competitive constraint imposed upon the combined entity.

Scope for the Exercise of Coordinated Market Power

Introduction

123. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

124. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination (both explicit and tacit forms of such behaviour between firms are included); 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

125. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

126. Given the price fixing convictions in the meat industry in the North Island, the Commission has given careful consideration to whether the acquisition might materially increase the likelihood of coordination in the South Island. The Commission is of the view that there are some characteristics of the meat processing industry that may be conducive to coordinated market power.

Collusion

127. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 2. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the beef procurement market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

TABLE 2
Testing the Potential for 'Collusion' in the Beef Procurement Market

Factors conducive to collusion	Presence of factors in the market
High buyer concentration	Yes. The three firm concentration ratio of [ ]% is outside prescribed safe harbours
Undifferentiated product	Yes. Some attempts to differentiate product in terms of quality but largely a commodity product
New entry slow	No. New entry can be achieved on a relatively quick basis through recycling of plants
Lack of fringe competitors	No. There are several smaller fringe competitors with the ability to expand their operations
Price inelastic supply curve	Yes. Supply curve likely to be quite inelastic in the short-run. In a given year, dairy farmers (in particular) make decisions to supply stock mostly on factors other than price
Industry's poor competition record	Yes. While there have been no convictions for price fixing in South Island, North Island meat processing companies were convicted of price fixing in 1995

Factors conducive to collusion	Presence of factors in the market
Presence of excess capacity	No. Most firms in the market expanding capacity to meet expected increase in supply over next few years
Presence of industry associations/fora	Yes. Large number of industry bodies

128. The assessment of the relevant structural and behavioural conditions in the beef procurement market in Table 2 suggests that the market has several characteristics that are likely to be conducive to collusion. The question is whether or not the likelihood of collusion is materially enhanced by the acquisition.

129. Although several factors above are suggestive of the increased potential for collusion there are some factors that are not.

130. As discussed above, there are currently a number of smaller operators that are in a position to expand their operations and compete vigorously for cattle. These include:

?? Ashburton Meat Processors/Malvern Abattoirs – [ ];

?? Blenheim Master Butchers – [ ];

?? Prime Range Meats – [ ].

131. The presence of smaller operators would make it difficult for the larger firms to collude because the incentive to "cheat" by smaller firms would be very high.

132. Expansion is likely to be possible in a relatively timely manner. The best strategy is likely to be to reopen and/or upgrade an existing plant. Several firms in the industry are currently engaged in this process.

133. Excess capacity is not present in the industry as it was in the North Island during the price fixing period. Rather, most firms are expanding their operations to cope with the projected increase in supply of cull cows from the dairy industry boom.

134. It is recognised that there will be a down-turn in the industry at some point in the future that may lead to excess capacity. However, it is unlikely to return to the levels witnessed in the North Island in the 1980's. During that period high barriers to exit and the removal of price support schemes (which led to reduced stock herds) left the market with substantial excess capacity. Today, there are fewer regulatory distortions in the market, allowing market forces to determine supply and demand. Changes to labour laws, which made shift work feasible, have substantially increased the productivity and flexibility of processing plants.[18] The pressures of excess capacity as a factor in price fixing are therefore not likely to reappear to the extent witnessed in the 1980s and early 1990s.

[18] *See* "The Structure and Dynamics of New Zealand Industries", Chapter 2: Red Meat, CW Maughan, p 31.

135. Unlike the North Island, most of the processing capacity in the South Island is owned by farmer-owned cooperatives (that is, Alliance and PPCS). The profits of these cooperatives are distributed back to the farmers, which arguably lessens the incentive to fix prices for the procurement of stock. However, the Commission has not previously given much weight to the argument that cooperatives have different incentives from purely commercial entities with respect to price fixing. Instead, they are typically considered by the Commission to be normal profit-maximising firms.[19]

Conclusion on Collusion

136. Overall, there appear to be sufficient safeguards present in the market to ensure the proposed acquisition would not materially enhance the possibility of collusion.

Discipline

137. For coordination to be successful, deviations of individual firms from the collusive behaviour have to be discouraged by being detected swiftly and punished by the other firms.

138. The structural and behavioural factors that are usually considered to be conducive to 'discipline' in co-ordinated markets are set out in the left-hand column in Table 3. Again, the significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the beef procurement market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'discipline; a high proportion of 'no' responses the reverse.

TABLE 3
Testing the Potential for "Discipline" in the Beef Procurement Market

Factors conducive to discipline	Presence of factors in the market
High buyer concentration	Yes. Three firm concentration ratio outside prescribed safe harbours
Sales small and frequent	Yes. Processing firms will potentially deal with thousands of farmers. However, some movement towards longer term supply arrangements
Absence of vertical integration	Yes. Limited vertical integration
Supply slow growing	No. Expectations are for supply of stock to increase significantly over next few years
Firms have similar costs	Yes. Market participants were of the view that costs are virtually identical amongst players
Price transparency	Yes. Schedule prices are freely available from most firms, although "premiums" may be added

[19] See, for example, *Ravensdown/SouthFert*, Decision 279, 21 June 1996, *Dairy Merger,* Draft Determination, 27 August 1999, *The New Zealand Co-operative Dairy Company Limtied & Anor v Commerce Commission* (1991) 3 NZBLC 102,059.

139. The assessment of the relevant structural and behavioural conditions in the beef procurement market in Table 3 suggests that the market is one where discipline could be maintained, should a collusive understanding or arrangement be attained. All factors that tend to be conducive to discipline appear to be present in varying degrees. The exception is the growth in supply. Over the next few years supply is expected to grow significantly on the back of the dairy boom. Generally, fast growing supply is not conducive to discipline because a defection by one player and subsequent gains in market share will not necessarily translate into market share loss for another player. Notwithstanding, participants in the industry seem to have relatively good knowledge of the stock kill numbers of their competitors.

Conclusions – Co-ordinated Market Power

140. The market contains some characteristics that tend to facilitate collusion and discipline. However, there are additional factors that are not conducive to collusion and discipline. On balance, it would not appear that the proposed acquisition will materially enhance the likelihood of coordinated power.

Conclusions – Existing Competition

141. The Commission considers that existing competition will alleviate any concerns of unilateral power being exercised by the merged entity.

142. The Commission considers that the scope for the exercise of coordinated market power would not be materially enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

143. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

144. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

145. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

146. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

147. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader 'entry conditions' that apply, and then go on to evaluate which of those constitute entry barriers.

148. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

149. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity.

150. The Commission has assessed entry conditions in the meat processing market on several occasions.[20] Entry conditions that have been identified include:

- satisfying regulatory requirements for new plant – including resource management requirements and MAF standards;
- obtaining quota – to enable a firm to sell significant volumes;
- finance – raising sufficient capital to fund the entry
- exit costs – risks associated should the venture fail include redundancy and clean-up costs.

For de novo entry, the investment in plant is mostly sunk.

151. The question is whether the entry conditions above would deter new entry. The conclusion reached by the Commission in past investigations is they would not deter entry, when stock numbers are increasing. This would appear consistent with the new entry and expansion witnessed in recent years.

152. At present supply of stock for slaughter is high and increasing. Virtually all competitors in the market are planning expansion of their capacity in some way. That would suggest that if any barriers do exist, they are not sufficient to deter expansion.

The "LET" Test

153. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

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[20] *See* Weddel New Zealand Limited, Decision 273, 2 February 1995; Richmond Limited/Lowe Walker NZ Limited, Decision 316, 11 February 1998; and Richmond Limited/Waitotara Meat Company Limited, Decision 371, 6 September 1999.

Likelihood of Entry

154. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

155. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

156. While there are risks involved in establishing a new plant or "re-cycling" an existing plant, history has shown that when market conditions are right expansion and new entry using the "re-cycling" strategy will occur. As noted above, prices are particularly good in the beef industry and virtually all competitors in the market are planning expansion of some kind. Despite the risks and exit costs, this would suggest that the returns possible in the "good times" (when supply of stock is high) out-weigh the potential losses and costs associated with closures during the "bad times".

157. It would not appear that a new entrant would have any difficulties in finding markets to sell its processed meat. A provision of the current quota system allows up to 3% of the USA beef quota for new entrants. In the past this 3% has proven to be more than enough for new entrants. In addition, the USA is by no means the only export option for a processing firm.

Extent of Entry

158. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

159. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

160. There would not appear to be any significant impedients that would prevent a new entrant from expanding its operations. CMP itself started its beef operations in 1994 (having purchased the Seafield Fortex plant) and has expanded its operations to the point of being one of the largest processors in the South Island.

161. A characteristic of the beef procurement market is that prices are quite transparent and are well-known throughout the industry. Market participants have advised the Commission that processors will generally look to match the best price offered in a

given week. Therefore, even entry on relatively small basis has the potential to affect price to a degree.

Timeliness of Entry

162. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

163. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

164. Time of entry is likely to be around eighteen months for a greenfields plant. Re-opening an existing plant is likely to take significantly less time.

Conclusion on the LET Test

165. The Commission concludes that the various components of the LET test are satisfied.

Conclusion on Barriers to Entry

166. The Commission concludes that the barriers to entry are not likely to deter expansion or new entry, which rely on recycling existing plants. Although de novo entry is less likely, potential competition is likely to provide constraint on the merged entity, and the industry as a whole.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

167. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

168. While Phoenix competes strongly for livestock, it is not markedly different from any other firm in the industry in that respect. Given the other constraints listed above, its removal is unlikely to have a disproportionate effect on competition in the market.

Constraint from Buyers or Suppliers

169. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

170. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

171. The suppliers of beef to the merged entity are farmers, who individually are likely to have very little countervailing power. Therefore, constraint provided by the countervailing power of farmers is not likely to provide significant constraint.

Efficiencies

172. The Commission recognises that there may be circumstances where efficiencies are relevant to an application for clearance.[21] In the context of a business acquisition, the combined entity might be able to make efficiency gains that are not obtainable by other means, such that its unit cost of production would decline. This could result in the entity reducing its price below that obtaining prior to the acquisition, even though with the acquisition it would otherwise be considered to have substantially lessened competition, and would be able to raise price above costs.

173. Where the applicant can make a sound and credible case that such efficiencies will be realised, that they cannot be realised without the acquisition, and that they will enhance competition in the relevant market, the Commission will include them in the broader analysis of all of the competitive effects of the acquisition in the course of assessing whether or not competition is likely to be substantially lessened. However, the Commission envisages that efficiency claims of the required magnitude and credibility will only very rarely overturn a finding that competition would otherwise be substantially lessened.

174. While the applicant has indicated that there are likely to be some synergy gains through the acquisition, the applicant has not argued that efficiencies should be the basis for a clearance. The Commission does not consider that it is necessary to form a view on efficiency gains in the context of this application.

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[21] In *Fisher & Paykel*, considered under s 27, the Court held that in assessing "substantial lessening of competition", a net approach to assessing anti-competitive effects was required: "The majority correctly accepted that it had to 'net out' the pro and anti-competitive effects and that, if it could be shown that the net effect of the EDC was to promote competition, then there could be no substantial lessening of competition." *Fisher & Paykel v Commerce Commission* [ ] 2 NZLR 731 at 740. See also: *Commerce Commission v Port Nelson*, supra n 6,433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463, 531.

OVERALL CONCLUSION

175. The Commission has considered the probable nature and extent of competition that would exist in the market for the procurement of beef for slaughter and processing in the South Island, but for the acquisition.

176. The proposed acquisition would result in the merged entity obtaining a market share that falls outside the Commission's safe harbour guidelines.

177. The Commission has considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- ?? existing competition;
- ?? potential competition from entry; and
- ?? other competition factors.

178. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for the procurement of beef for slaughter and processing in the South Island.

DETERMINATION ON NOTICE OF CLEARANCE

179. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the business acquisition by Canterbury Meat Packers Limited or one of its interconnected bodies corporate of up to 100% of the shares in or assets of Phoenix Meat Company Limited and/or any of its interconnected bodies corporate.

Dated this 31st day of August 2001

MJ Belgrave
Chair