

## Statement of Preliminary Issues

### Sealord/Independent Fisheries

20 October 2023

#### Introduction

1. On 20 September 2023, the Commerce Commission registered an application (the Application) from Sealord Group Limited (Sealord) seeking clearance to acquire the entire Independent Fisheries business (the Proposed Acquisition).<sup>1</sup> With the Proposed Acquisition, Sealord would acquire:
  - 1.1 assets, fishing quota and the related annual catch entitlement (ACE), and all of the shares in Independent Fisheries Limited from Independent Fisheries Holdings Limited (together, Independent Fisheries); and
  - 1.2 a cold storage facility in Woolston, Christchurch.<sup>2</sup>
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.<sup>3</sup>
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **3 November 2023**.

#### The parties

5. Sealord and Independent Fisheries (together, the Parties) are operators of vertically integrated deepwater fishing companies based in the South Island.

#### Sealord

6. Sealord is one of the largest seafood businesses in the Southern Hemisphere, employing over 1000 people in New Zealand, and is operated out of Nelson. It is a wholly-owned subsidiary of Kura Limited (Kura) which itself is owned in equal shares

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<sup>1</sup> A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

<sup>2</sup> See the Application at [1.1] for further details of the assets and shares of Independent Fisheries' business that Sealord is proposing to acquire.

<sup>3</sup> The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

by Nissui Corporation and Aotearoa Fisheries Limited, trading as Moana New Zealand (Moana).<sup>4</sup>

7. Sealord is primarily involved in operating a deepwater fishing business which includes:<sup>5</sup>
  - 7.1 the operation of a fleet of eight deepwater fishing vessels, seven of which are active in New Zealand waters;
  - 7.2 holding deepwater fishing quota (and associated ACE) which is held for use by Sealord by Pupuri Taonga Limited as trustee under a trust;<sup>6</sup>
  - 7.3 harvesting a range of deepwater finfish species, such as hoki, jack mackerel, southern blue whiting, barracouta, ling, orange roughy as well as deepwater squid;
  - 7.4 processing of various finfish species onboard its vessels and at its Nelson factories, and the production of value-added fish products, such as coated dory fillets, battered and crumbed hoki and fish fingers; and
  - 7.5 the sale of a range of mostly frozen processed and whole fish, and frozen value-added products, most of which are exported, with domestic sales mainly limited to the major grocery retailers and food service companies.
  
8. In addition to Moana's 50% shareholding in Sealord, Sealord has a 50% shareholding in Westfleet Seafoods Limited (Westfleet), an inshore fishing business that also fishes for some deepwater species, including under contract harvesting arrangements with Sealord. We will consider whether Moana, Sealord and/or Westfleet should be treated as interconnected or associated persons.

### **Independent Fisheries**

9. In the Application, Sealord submits that Independent Fisheries is the fourth largest deepwater fishing company in New Zealand, with over 500 staff and vessel crew, and is operated out of Lyttelton, Christchurch.<sup>11</sup> Independent Fisheries' operations include:<sup>12</sup>
  - 9.1 the operation of a fleet of deepwater fishing vessels (two owned and one chartered);
  - 9.2 holding deepwater quota (and associated ACE);

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<sup>4</sup> Moana is a Māori-owned fisheries company, which was established under the Māori Fisheries Act 2004 as custodian of commercial fishery assets returned to Māori under Treaty of Waitangi fisheries settlements with the Crown. Moana has 58 mandated iwi organisations as shareholders.

<sup>5</sup> The Application at [5.5]-[5.9].

<sup>6</sup> The Application at [5.12]. Sealord also holds a 50% interest in NZLL Quota Co Limited (NZLL), with the other 50% shareholding held by Talley's (the Application at [4.18]). NZLL owns king crab and ling quota.

- 9.3 harvesting a range of deepwater finfish species, such as hoki, jack mackerel, southern blue whiting and barracouta, as well as deepwater squid;
- 9.4 processing the fish it harvests in processing facilities onboard its vessels; and
- 9.5 the sale of fish primarily for export, with domestic sales confined to a small amount of frozen fish which is either:
  - 9.5.1 sold for food-related purposes; or
  - 9.5.2 toll processed and sold as value-added products to United Fisheries Limited for sale in New Zealand; or
  - 9.5.3 sold for use in pet food products.

### Industry background

- 10. Both Sealord and Independent Fisheries operate commercial deepwater fishing businesses. We understand that commercial deepwater fishing companies engage in some or all of the following supply chain activities:<sup>7</sup>
  - 10.1 obtaining quota and/or ACE for the harvesting of fish under the Quota Management System operated by the Ministry of Primary Industries, explained further below;
  - 10.2 harvesting fish: a commercial deepwater fishing business will typically operate its own boats, with their own crews. Deepwater fishing vessels typically harvest fish in areas between 12 and 200 nautical miles offshore and will harvest fish for several weeks at a time before returning to shore;<sup>8</sup>
  - 10.3 primary processing (being heading, gutting, filleting and freezing fish, as well as tubing squid): typically, deepwater vessels undertake primary processing onboard immediately after fish is caught;<sup>9</sup>
  - 10.4 onshore secondary processing: deepwater fishing companies may also carry out secondary processing of fish, which includes coating, battering and other further processing of fish into 'value-added' products. This secondary processing is typically completed onshore;<sup>10</sup> and
  - 10.5 wholesale supply: while most fish and value-added products supplied by deepwater fishing companies are exported, at least some product is supplied domestically. New Zealand wholesale customers include the major grocery

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<sup>7</sup> For example, see the Application and Commerce Commission Moana/Sanford Statement of Issues (27 July 2023).

<sup>8</sup> The Application at [10.28].

<sup>9</sup> The Application at [10.32]. We understand some deepwater fishing companies also carry out some of their primary processing at onshore facilities.

<sup>10</sup> The Application at [10.32].

retailers, specialty fish wholesalers and retailers, food service providers and online platforms.

### Requirements for commercial fishing in New Zealand

11. Commercial fishing of the most popular species of fish in New Zealand is regulated by the Fisheries Act 1996, which is designed to ensure that fish stocks are managed sustainably. The Fisheries Act achieves this through the Quota Management System (QMS), which sets annual catch limits for regulated species and financial penalties (known as deemed values) that apply when fish are landed without ACE. Broadly, the QMS works as follows:
  - 11.1 For each regulated species of fish, the population in New Zealand waters is organised into several geographic Fishstocks.<sup>11,12</sup> For each Fishstock (for example HOK1 for hoki), quota was issued to a list of quota holders – often fishing companies but sometimes other parties – when the QMS was established. Quota is an indefinite right to be allocated ACE each year in proportion to the quota shares owned by the holder. A single permit of ACE for a Fishstock (HOK1, for example) is the right to land 1kg of fish from the stock without paying a deemed value penalty for it. Every Fishstock has 100 million total quota shares, so that a quota holder with 10 million shares, for example, is allocated 10% of the available ACE each year.
  - 11.2 For each Fishstock, ACE is generated each year when MPI sets the Total Allowable Commercial Catch (TACC). The TACC is the kilogram volume of fish that can be caught that year from the stock without deemed value penalties. Deemed values vary between Fishstocks and rise on sliding scales for larger amounts of fishing that is not covered by ACE.
12. ACE is freely tradable. Commercial fishing businesses often obtain significant amounts from their own quota holdings but may also buy or lease extra when they are short for particular Fishstocks that they fish, or sell surplus. An ACE holder can also carry over ten percent of a holding for a given Fishstock into the following year. Quota is less freely tradable because it is subject to aggregation limits set by MPI. In practice, it is also traded less frequently than ACE is.

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<sup>11</sup> Using examples of some of the species fished by the Parties to the Proposed Transaction, there are two Fishstocks for Hoki and five for Southern Blue Whiting. For most species of deepwater fish, there are usually relatively few Fishstocks, each one covering a large part of New Zealand's waters. For inshore species, such as Snapper, there are typically more stocks – with individual stocks covering, for example, the west coast of the North Island, the north coast of the North Island, etc.

<sup>12</sup> Deepwater finfish Fishstocks can also be classified into tiers which reflect their commercial value and volume. Tier 1 relates to Fishstocks for high volume and/or value species, such as hoki and southern blue whiting. Tier 2 relates to Fishstocks for lower volume and/or value species, such as barracouta and gemfish. There is also a Tier 3, which relates to species that do not fall under the QMS.

## Our framework

13. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.<sup>13</sup> As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
14. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).<sup>14</sup> This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
15. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we will consider, among other matters:
  - 15.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
  - 15.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
  - 15.3 the countervailing market power of buyers – the potential constraint on a business from a purchaser’s ability to exert substantial influence on negotiations.

## Market definition

16. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act 1986, as a matter of fact and commercial common sense.<sup>15</sup>
17. As Sealord and Independent Fisheries both operate vertically integrated deepwater fishing businesses in New Zealand, the Proposed Acquisition has the potential to result in overlap at different levels of the deepwater fishing supply chain set out above.

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<sup>13</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, May 2022. Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz).

<sup>14</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

<sup>15</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

18. In the Application, Sealord submits that the relevant markets for the Commission's assessment of the Proposed Acquisition are:<sup>16</sup>
- 18.1 a national market for the harvesting of finfish (including squid);
  - 18.2 a national market for the processing and wholesale supply of whole and processed finfish; and
  - 18.3 a national market for the processing and wholesale supply of value-added finfish (such as battered or crumbed products).
19. We will test whether the markets proposed by Sealord are the most appropriate for assessing the competitive effects of the Proposed Acquisition, or whether the impact of the Proposed Acquisition is more appropriately assessed with reference to other markets. In particular, we currently intend to focus on the following issues.
- 19.1 The relevant product market(s) for the supply of quota and ACE. With the Proposed Acquisition, Sealord would acquire Independent Fisheries' quota and the related ACE. We will consider whether this may have an impact on any potential market(s) for the supply of quota and/or ACE or on any downstream markets for the supply of fish to customers.
  - 19.2 The relevant product and geographic market(s) for the supply and/or acquisition of deepwater harvesting services.
  - 19.3 The relevant product market(s) for the supply of primary processing services (such as heading, gutting, filleting and freezing), including whether the processing services performed onboard deepwater vessels compete with the same services performed in onshore processing facilities.
  - 19.4 The relevant product and functional market(s) for the supply of secondary processing services, including whether:
    - 19.4.1 coating, battering and/or any other type of secondary processing of frozen fish is substitutable, such that there is one 'value-added' product dimension encompassing all value-added products; and
    - 19.4.2 such services are distinct from primary processing services (meaning they should be considered as a separate functional level of the supply chain).
  - 19.5 The relevant product and geographic market(s) for the supply of cold storage services.

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<sup>16</sup> Sealord notes that these are the same markets as those defined in the Commission's Decision 388, *New Zealand Seafood Investments/Basuto Investments*, 30 March 2000 (The Basuto Decision). However, we note the Basuto Decision was a majority decision reached under urgency. K M Brown and E M Coutts dissented on the basis that the timeframe did not provide them with sufficient time to be satisfied on all issues.

- 19.6 The relevant product market(s) for the wholesale supply of whole and primary processed frozen fish.
- 19.6.1 At this preliminary stage, we consider that we are likely to be able to assess the supply of whole and primary processed frozen fish together, on the basis that all major fishing companies appear able to supply fish in either state, mainly using their own facilities. We will investigate whether the other competitive dynamics relating to the supply of whole and primary processed frozen fish are sufficiently similar that it is indeed appropriate to consider both forms of supply together for the purposes of our analysis.<sup>17</sup>
- 19.6.2 We anticipate that an important aspect of our investigation will be to determine the scope and composition of the product market(s) themselves, in terms of the specific fish species (both deepwater and inshore) that are sufficiently substitutable for each other that they should be considered to fall within a single product market.<sup>18</sup>
- 19.6.3 At this stage we consider that sales of frozen fish are unlikely to be constrained by sales of fresh fish of the same or substitutable species, since fresh fish is usually significantly more expensive than frozen fish.<sup>19</sup> However, we will test the substitutability of fresh and frozen fish further as part of our assessment.
- 19.7 The relevant product market(s) for the wholesale supply of value-added products, including whether different value-added formats are substitutable for one another.
- 19.6 The customer dimension(s) for any relevant market, particularly the extent to which:
- 19.6.1 different purchasers of primary and secondary processing services have different requirements and therefore should be considered separately; and
- 19.6.2 different wholesale customers, such as retail and food service customers have different requirements and therefore should be considered separately.
20. Where we have not indicated that geographic market definition is likely to be a key focus (for quota/ACE, processing and wholesale supply), we currently consider that

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<sup>17</sup> However, if the evidence indicates that some suppliers have more limited processing capabilities, or could be vulnerable to input foreclosure after the Proposed Acquisition, we may then be required to undertake a separate assessment of processed supply.

<sup>18</sup> We note that the relevant product market(s) for the wholesale supply of whole and processed frozen fish could include inshore species as well as the deepwater species supplied by the Parties, since some inshore and deepwater species can be substitutes for consumers.

<sup>19</sup> For example, see Commerce Commission Moana/Sanford Statement of Issues (27 July 2023).

the relevant markets are likely to be national. However, we will also assess whether it may be appropriate to define regional or local geographic markets in any case.

### **Without the acquisition**

21. We will consider what the Parties would do if the Proposed Acquisition did not go ahead. We will consider the evidence on whether, as submitted by Sealord, the without-the-acquisition scenario is best characterised by the status quo, or whether Independent Fisheries would seek alternative options such as finding a different buyer for its business.<sup>20</sup>

### **Preliminary issues**

22. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in any of the relevant markets by assessing whether horizontal unilateral, vertical or conglomerate, or coordinated effects might result from the Proposed Acquisition. The questions that we will be focusing on are:
- 22.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?<sup>21</sup>
- 22.2 vertical or conglomerate effects: would the Proposed Acquisition increase the merged entity's ability and/or incentive to foreclose rivals in a relevant market, for example by limiting access to a key input or restricting access to customers?
- 22.3 coordinated effects: would the Proposed Acquisition change the conditions in the relevant market(s) so that coordination is more likely, more complete or more sustainable?

### **Unilateral effects: would the merged entity be able to profitably raise prices by itself?**

23. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase prices above the level that would prevail without the merger (or depress prices in a buying market), without being thwarted by rival firms' competitive responses.<sup>22</sup>
24. In the Application, Sealord submits that the Proposed Acquisition is unlikely to substantially lessen competition due to unilateral effects in any relevant market, for reasons including:

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<sup>20</sup> The Application at [15.1].

<sup>21</sup> For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, ie, it could increase quality-adjusted prices.

<sup>22</sup> *Mergers and Acquisitions Guidelines* above n13 at [3.62].



- 24.1 in relation to the supply of ACE, neither Sealord nor Independent Fisheries trade large volumes of ACE and Sealord will continue to face strong competitive constraint in the supply of ACE from other deepwater fishing companies;<sup>23</sup>
- 24.2 in relation to the acquisition of harvesting services, contract harvesting in deepwater fishing is rare and any contract harvesting carried out by the Parties is so small as to not result in a substantial lessening of competition;<sup>24</sup>
- 24.3 in relation to the supply of onboard primary processing services, onshore secondary processing services and onshore cold storage services, there is limited competition as most operators self-supply and Sealord would face strong competition from a number of vertically integrated deepwater fishing companies, as well as third parties with spare processing capacity;<sup>25</sup>
- 24.4 in relation to the wholesale supply of both primary and secondary processed frozen fish:
- 24.4.1 Independent Fisheries has minimal presence domestically, as almost all of its products are exported;<sup>26</sup>
- 24.4.2 Sealord would face strong competition from a number of vertically integrated deepwater fishing companies such as Talley's and Sanford who have excess capacity to increase supply to the domestic market(s);<sup>27</sup>
- 24.4.3 Sealord and other deepwater fishing companies would face strong competition from imported frozen products, salmon, other seafood products such as prawns and other non-seafood proteins such as chicken;<sup>28</sup> and
- 24.4.4 the main downstream customers would hold significant countervailing buyer power.<sup>29</sup>
25. In any relevant market, we will consider:
- 25.1 closeness of competition: the degree of constraint that the Parties impose upon one another and the competition that would be lost as a result of the Proposed Acquisition;;

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<sup>23</sup> The Application at [17.21].

<sup>24</sup> The Application at [17.13].

<sup>25</sup> The Application at [17.46.3] and [17.46.8].

<sup>26</sup> The Application at [17.46.1] and [17.52.1].

<sup>27</sup> The Application at [17.25].

<sup>28</sup> The Application at [17.46.13] and [17.52.9].

<sup>29</sup> The Application at [17.46.12] and [17.52.7].

- 25.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;
- 25.3 entry and expansion: how easily rivals could enter and/or expand to constrain the merged entity; and
- 25.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

**Vertical effects: would the merged entity be able to foreclose rivals?**

- 26. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively (which we refer to as ‘foreclosing rivals’).<sup>30</sup>
- 27. The Proposed Acquisition would effectively give Sealord an increased presence in all of the upstream activities in the supply of deepwater fish and value-added products to customers because it will have more quota and ACE, more fishing vessels, and more capacity in processing and cold storage than in the counterfactual.
- 28. We will assess whether this could result in vertical effects in connection with any input affected by the Proposed Acquisition. This may be the case if the Proposed Acquisition increases the merged entity’s ability and incentive to refuse to supply an input(s) and/or raise the input’s price so as to foreclose competitors in downstream markets. At this stage, we consider that the most likely source of any vertical effects arising from input foreclosure could be the supply of quota or ACE, since it appears that deepwater fishing companies need to acquire ACE from rivals more often than other inputs.
- 29. As noted above, the Proposed Acquisition would give Sealord an increased holding of fishing quota (and therefore ACE) for multiple species of deepwater fish. In addition to potentially giving rise to unilateral effects this aggregation could also affect the Parties’ ability and incentive to foreclose rivals. This may be the case if:<sup>31</sup>
  - 29.1 The merged entity would gain significant share of ACE for Fishstock X1 that rival deepwater fishing companies need to buy (to cover intended catch of species X or bycatch of X when targeting species Y, in waters overlapping with X1), then the merged entity may be able to foreclose competitors in the downstream supply of X or Y by refusing to supply the necessary ACE or increasing its price.
- 30. This theory relates to the supply of ACE for catch balancing purposes (covering bycatch of other species, as discussed at 29.1 above), which primarily occurs during

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<sup>30</sup> *Mergers and Acquisitions Guidelines* above n13 at [5.1]-[5.5].

<sup>31</sup> We note that this theory is related to potential unilateral effects in the supply of ACE to rivals. Viewing ACE as an input to the downstream supply of fish, unilateral effects upstream could cause vertical effects in relevant downstream markets for the wholesale supply of fish to customers.

the fishing year. We will also consider whether the Proposed Acquisition may also raise barriers to entry or expansion for the Parties' rivals, by providing the merged entity with the ability and incentive to withhold supply of any quota or ACE that, in the counterfactual, those rivals might otherwise have been able to secure under long-term arrangements.

31. As part of our assessment, we will also be considering:
  - 31.1 rival deepwater fishing companies' ACE requirements, to assess the extent to which rivals require externally sourced ACE to operate deepwater vessels;
  - 31.2 the extent to which the Parties supply ACE for deepwater species to rivals, to assess whether the Proposed Acquisition may remove a previously relied-upon source(s) of ACE for rivals; and
  - 31.3 the alternative source/s of ACE available to rivals, to assess whether, if the Parties' ACE is no longer available to rivals, sufficient ACE remains on the open market.

#### **Coordinated effects: would the Proposed Acquisition make coordination more likely?**

32. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.<sup>32</sup>
33. Sealord submits that the relevant markets are not vulnerable to coordination, arguing that:<sup>33</sup>
  - 33.1 the Parties' competitors vary in size, location, cost structures and margins;
  - 33.2 prices are not transparent, and arrangements are instead the subject of bilateral negotiations between parties;
  - 33.3 the Proposed Acquisition will not remove a "maverick" competitor; and
  - 33.4 customers have a substantial degree of countervailing power.
34. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in these markets so that coordination is more likely, more complete or more sustainable.

#### **Steps in our investigation**

35. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **16 November 2023**. However, this date

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<sup>32</sup> *Mergers and Acquisitions Guidelines* above n13 at [3.84].

<sup>33</sup> The Application at [19.1].

may change as our investigation progresses.<sup>34</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to be extended.

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

### **Making a submission**

37. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference 'Sealord/Independent Fisheries' in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **3 November 2023**.
38. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website. If you make a submission and we do not acknowledge receipt of that submission within two working days, you should resubmit your submission.
39. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

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<sup>34</sup> The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.