

## Statement of Preliminary Issues

Fonterra / NZDL

12 July 2012

### Introduction

1. On 6 July 2012, the Commerce Commission received an application from Fonterra Co-operative Group Limited (Fonterra) seeking clearance to acquire the dairy processing assets of New Zealand Dairies Limited (NZDL). The public version of the application can be accessed on the Commission's website at <http://www.comcom.govt.nz/clearances-register/detail/758>
2. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
3. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger. The Commission requests that parties wishing to make a submission do so by **20 July 2012**.

### Relevant parties

#### The acquirer – Fonterra

4. Fonterra is New Zealand's and the world's largest dairy exporter and it has a prominent position in all aspects of the dairy industry in New Zealand including operating a number of milk powder processing plants in the South Island.

#### The target – NZDL

5. NZDL owns a milk powder processing plant at Studholme, near Waimate and until recently it has been collecting raw milk from farmers in the South Canterbury and North Otago regions. NZDL's plant has been operating since it was commissioned in 2007.
6. NZDL's parent company, Nutriek Group which is based in Russia, was recently declared bankrupt. Subsequently, NZDL was placed in receivership on 17 May 2012. The receiver for NZDL then conducted a sales process for the NZDL dairy processing assets in which Fonterra was selected as the preferred purchaser.

### Analytical framework

7. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. An important step in

the Commission's analytical framework<sup>1</sup> is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the acquisition. The Commission then considers the relevant products and geographic regions that may be close substitutes from both a customer's and a supplier's point of view.

8. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:
  - with the acquisition in question
  - without the acquisition.
9. The impact of the acquisition on competition is then viewed as the difference between those two scenarios.
10. The Commission analyses the extent of competition in each relevant market for both the with and without scenarios, in terms of:
  - Existing competition – the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices.
  - Potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so.
  - The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser's ability to exert an influence on price, quality and/or terms of supply.
  - Coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
11. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition might lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

### **Preliminary issues**

12. The Commission intends to focus its investigation on the following areas:

#### **Areas of overlap**

13. Fonterra's submission is that the relevant markets in this case should be:

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<sup>1</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

- The South Island market for the supply and collection of raw milk
  - The South Island market for raw milk processing assets.
14. The Commission will consider the competitive alternatives for the existing suppliers of raw milk to NZDL and whether the relevant markets are as broad as Fonterra contends. That is, whether the geographic dimension of the markets are as broad as the South Island or are limited to perhaps, Canterbury.

#### **Situation without the acquisition**

15. NZDL is currently in receivership so the Commission will consider NZDL's position in the relevant market(s) if the proposed acquisition does not go ahead.
16. Fonterra considers that, absent the acquisition, there is only a small probability that an alternative purchaser to Fonterra would be found, particularly one who would be able to complete a timely purchase of NZDL's assets, while preserving the loyalty of NZDL's existing suppliers.

#### **Existing competition**

17. Fonterra submits that most suppliers of raw milk in the South Island have a choice of processor and these suppliers will continue to have alternative options to Fonterra, should Fonterra acquire NZDL.
18. The Commission will consider the viability of these alternative options for both existing and potential suppliers of raw milk to NZDL.
19. The Commission will also consider whether Fonterra, as the purchaser of over 80% of raw milk from farmers (farm gate milk) in the South Island, in practice sets the price for farm gate milk and whether that would be the same with and without the acquisition.

#### **Potential competition**

20. Fonterra considers that the threat of entry and expansion acts as a real constraint on Fonterra and this will continue to be the case post acquisition.
21. The Commission will consider whether there are sufficient incentives in the current economic environment for new processors to enter/start-up.

#### **Countervailing power**

22. Fonterra considers that the existing regulatory regimes within the dairy industry and the co-operative nature of its ownership structure would prevent it from exercising any increase in market power that might arise from the acquisition.

#### **Next steps**

23. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at [www.comcom.govt.nz](http://www.comcom.govt.nz)), the Commission has established a draft timeframe for considering Fonterra's application.

An extension of time has been agreed to by the Applicant and the Commission should make its final decision by **31 August 2012**. However, this timeframe could change. To keep abreast of possible changes to timing and to find relevant documents, visit the Clearance Public Register on the Commission's website at:

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

24. The Commission will be contacting parties it believes will provide the best information to help it assess the preliminary issues identified above over the next few weeks.
25. The Commission also invites submissions from any other parties who consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference **Fonterra/NZDL** in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by **4pm** on **Friday 20 July 2012**. Please clearly identify any confidential information contained in the submission and provide contact details.