

Statement of Preliminary Issues

The Wallace Group Limited Partnership /Wallace Corporation Limited and Farm Brands Limited and Keep It Clean Limited

9 August 2016

Introduction

1. The Wallace Group Limited Partnership (WGLP) is proposing to acquire up to 100% of the assets and business of:
 - 1.1 Wallace Corporation Limited (Wallace);
 - 1.2 Farm Brands Limited, Farm Brands Asset Management Limited and South Canterbury By-Products (2009) Limited (collectively Farm Brands); and
 - 1.3 Keep It Clean Limited (Keep It Clean).
2. On 26 July 2016, the Commerce Commission registered an application from WGLP seeking clearance for the proposed acquisition.¹
3. The Commission will give clearance if it is satisfied that the acquisition will not have or would not be likely to have, the effect of substantially lessening of competition in a market in New Zealand.
4. This Statement of Preliminary Issues outlines the key competition issues we currently consider to be important in deciding whether or not to grant clearance.²
5. We invite interested parties to make comment on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **23 August 2016**.

The parties

6. WGLP is a limited partnership that consists of two limited partners: Modena Investments (New Zealand) Limited (the parent company of Farm Brands), and Wallace, and a third general partner: Wallace Group GP Limited. The three parties are involved in the collection and processing of renderable meat materials, and the supply of finished products from that process.

Wallace

7. Wallace owns two rendering plants:

¹ The public version of the application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/925>

² The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.

- 7.1 Waitoa (north Waikato), at which it renders bovine, poultry and casualty materials; and
 - 7.2 Hororata (near Christchurch), at which it primarily renders porcine (pork) material and general casualty material and the waste collected from small meat processors.
- 8. Wallace also supplies finished rendered material, including meat and bone meal, blood meal and inedible tallow, which it sells to end users and traders of these products, including Farm Brands.
 - 9. Aside from rendering, Wallace operates tannery and composting businesses in the North Island.

Farm Brands

- 10. Farm Brands owns two rendering plants:
 - 10.1 Washdyke (near Timaru), which processes bovine and ovine material as well as casualty stock and waste material collected from butchers' shops and small meat processors; and
 - 10.2 Silverstream (Mosgiel), which only processes bovine material.
- 11. Farm Brands also supplies finished rendered products, including meat and bone meal, blood meal, and inedible tallow from its own processing facilities and third-party facilities (including Wallace).

Keep It Clean

- 12. Keep It Clean is a privately-owned company that operates a rendering plant in Dunedin, at which it processes mainly cervine (deer) material, casualty stock and shop waste collected from butcheries and small meat processors. It also supplies finished rendered products, including meat and bone meal, cervine meal and inedible tallow.

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.³ As required by the Commerce Act 1986, we assess mergers 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

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz.

competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).⁴

15. We define markets in the way that we consider best isolates the key competition issues that arise from the acquisition. In many cases this may not require us to precisely define the boundaries of a market. A market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.⁵
16. We compare the extent of competition in each relevant market both with and without the acquisition. This allows us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we will not give clearance to the proposed acquisition. When making that assessment, we consider, among other matters:
 - 16.1 existing competition – the degree to which existing competitors compete.
 - 16.2 potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased; and
 - 16.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by a purchaser’s ability to exert substantial influence on negotiations.
17. A comparison of the extent of competition both with and without the acquisition enables us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed acquisition.

Market definition

18. In 2014, the Commission considered various rendering markets when investigating an application from Tuakau Proteins Limited for clearance to acquire certain assets from Lowe Corporation Limited (the *Tuakau* decision).⁶
19. Taking into account the market definitions adopted by the Commission in the *Tuakau* decision, the Applicant has submitted that the relevant markets are:
 - 19.1 the supply of toll rendering services to customers producing each of bovine/mixed material, ovine, cervine and pork raw material in the South Island;
 - 19.2 the direct collection separately of bovine/mixed material, ovine, porcine/mixed material, and cervine raw material from producers in the South Island;
 - 19.3 the shop collection of animal raw materials in the Canterbury region;

⁴ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁵ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁶ *Tuakau Proteins Limited and Graeme Lowe Protein Limited* [2014] NZCC 26.

- 19.4 the purchase for rendering of casualty material from each of the Canterbury and Southland regions; and
 - 19.5 the rendered outputs for the national supply of each of mixed meat and bone meal, blood meal, cervine meal and inedible tallow.
20. We propose to follow the approach adopted by the Commission in the *Tuakau* decision. In addition, we will consider:
- 20.1 whether there is a separate market for the collection of animal casualty material; and
 - 20.2 the geographic scope of the affected markets.

Preliminary issues

21. We will investigate whether the acquisition is likely to substantially lessen competition in the relevant markets. In particular, we will consider whether the merged entity:
- 21.1 could raise the price of toll rendering services above the competitive level;
 - 21.2 could profitably reduce prices paid for the collection of renderable material below competitive levels, or otherwise raise prices for the disposal of this product;
 - 21.3 could raise the prices for rendered output products in New Zealand; and
 - 21.4 would be able to coordinate with rivals.

Toll processing

22. Toll processing is where a renderer provides a processing service for a producer of raw material. The producer retains ownership of the material throughout the process and generally sells the finished products itself. The Applicant has submitted that:
- 22.1 the acquisition will not result in any overlap in the toll processing markets; and
 - 22.2 Silver Fern Farms is the only toll processing customer and currently contracts with Farm Brands to provide all of its South Island rendering requirements.
23. We will consider whether Wallace or Keep It Clean are potential competitors for toll processing services such that the transaction may reduce Silver Fern Farm's or any other toll manufacturing customer's options.

Collection markets

24. Renderers collect and purchase material for processing and sell the finished products. The acquisition will result in overlap in a number of geographically differentiated buying markets for the collection of renderable materials, particularly shop collection and casualty animal collection, and to some extent in the direct collection of animal waste material.

25. The Applicant submitted that:
- 25.1 there is no significant aggregation of market share in the direct collection of bovine and ovine renderable material because Wallace is not involved in the South Island bovine and ovine rendering markets and Keep It Clean is only a small participant in bovine rendering with no involvement in ovine rendering;
 - 25.2 in the market for the collection of pork and cervine rendering materials there will be no change to the market situation;
 - 25.3 in the Canterbury shop material collection there are no barriers to entry or expansion with customers likely to have alternative options; and
 - 25.4 the casualty collection market would remain competitive in Canterbury and Southland with no barriers to entry and expansion and collectors would continue to have alternative providers as viable options.
26. We will consider:
- 26.1 whether the merged entity would have the ability and incentive to depress prices to below the competitive level that it pays for the collection of renderable material, or starts charging for the removal of this product, because:
 - 26.1.1 customers in each of the markets find it difficult to switch to an alternative provider, such as Alliance, ANZCO or Value Proteins;
 - 26.1.2 there are barriers to entry or expansion; and
 - 26.2 whether any decrease in price would likely result in a reduction of the quantity of renderable material in the relevant markets.

Rendered output products

27. The rendering process results in a range of rendered products being made available. The Applicant has identified that the merger will result in overlap in the national supply of:
- 27.1 mixed meat and bone meal;
 - 27.2 blood meal;
 - 27.3 cervine meal; and
 - 27.4 inedible tallow.
28. The Applicant submitted that in each of the affected output product markets there are a large number of other competitors with the merged entity also likely to be constrained by international commodity prices.
29. As part of the investigation, we will consider:

- 29.1 the level of aggregation that is likely to result from the acquisition; and
- 29.2 the alternative options available to purchasers of rendered output products in New Zealand.

Coordinated effects

- 30. We will consider whether the merger increases the potential for the merged entity and all or some of its rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market.
- 31. We will also assess:
 - 31.1 whether any of the relevant markets are vulnerable to coordination; and
 - 31.2 whether the merged entity would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Next steps

- 32. The Commission is currently aiming to make a final decision on whether or not to give clearance to the merger by **20 September 2016**. However, this date may change as the investigation progresses.⁷
- 33. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

- 34. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Wallace Group 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 **23 August 2016**.
- 35. 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, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.

⁷ 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.