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INFORMATION**

**COMMERCE ACT 1986: BUSINESS ACQUISITION**

**SECTION 66: NOTICE SEEKING CLEARANCE**

Date: 15 October 2010

The Registrar  
Market Structure Team  
Commerce Commission  
PO Box 2351  
Wellington

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking clearance of a proposed business acquisition.

# Executive Summary

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## 1. Rationale

AsureQuality, a State-Owned Enterprise, and PSL, a private company, together with the Applicants, are domestic participants in a global laboratory “proficiency testing” (PT) market. They are vulnerable to overseas competition, both because each of them is reliant on New Zealand based tender markets and also because of their limited size and employee base compared to their overseas competitors. Overseas PT providers often have thousands of customers and dozens of employees, representing formidable international competition.

Furthermore, the Applicants lack the testing mass which would enable them to efficiently and sustainably compete in the international marketplace. Therefore both are constrained from achieving growth.

The proposed transaction aims to bring about the growth of sufficient mass and expertise to enable the merged entity to compete for the supply of PT services in the international market, and to better compete against international providers in the domestic market.

Benefits to the Applicants’ existing customers would include:

- improved accuracy of PT assessments through pooling of data between each of the Applicants’ customer groups;
- the ability to better maintain the necessary specialist competencies within each PT programme and to meet evolving requirements of international standards; and
- lower long-run costs through rationalising duplicated capabilities (increasing viability against global competition).

## 2. The Industry

PT services provide an assessment of the accuracy and quality of sample tests conducted by laboratories engaged in testing various industry products and other material, e.g., meat, dairy and milk products. By its nature, the PT market is very small compared to the laboratory testing market.

PT procedures involve the PT provider receiving results from a large cross section of laboratories engaged in testing related products or materials. The PT provider provides the same sample to each related laboratory it services and receives each laboratory’s assessment of the sample. From the combined test results, the PT provider can identify the correct test results as well as those laboratories which have not achieved the same outcome, thus indicating that they need to upgrade their service. In effect, a report is provided to each participating laboratory comparing their analytical performance with that of the pool of participants in the programme. The greater the mass of laboratory participants, the more accurately and credibly the proficiency outcomes can be determined.

The requirement for PT services is driven in part by domestic regulation (e.g., the meat industry) and the need for domestic exporters to satisfy international buyers and regulators that domestic laboratory testing meets international regulations or best standards.<sup>1</sup>

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<sup>1</sup> Accreditation to laboratory standards such as ISO Guide 17025 requires participation in PT where this is available.

There are a number of laboratories servicing different product industries that either seek or are required by regulators or acquirers of PT services to engage in PT of their laboratory testing quality. AsureQuality and PSL supply only some of those industries; principally those associated with meat, dairy, milk, water, soil and fats and oils. In respect of each of the meat, dairy and milk industries there is a dominant acquirer of PT services whose decision as to who the PT supplier shall be drives that decision for all the other industry laboratories. In respect of meat it is the NZFSA, in respect of dairy it is Fonterra and in respect of milk it is a collaboration between major milk testing laboratories (the **Raw Milk Laboratories Group**), including SAITL and Testlink. The remaining participant laboratories in respect of each of those industries either do not have sufficient testing mass to credibly support having a separate provider of PT services, or they have a need to ensure that their laboratory outputs are consistent with the dominant industry player.

Accordingly, in respect of each of those three industries, there is currently a sole supplier of PT services which only faces competition (from near or new entrants) when the respective industry or dominant industry participant determines to tender for supply.

AsureQuality and PSL also provide PT in respect of other laboratory services (**general PT services**) including soil, water and fats and oils etc. However, there is only market aggregation in respect of the results of laboratories testing water and fats and oils. In respect of all of these general PT services there is a ready availability of Internet-based competition from a variety of local and overseas competitors such as WEPAL and LGC Standards. Some providers specialise in respect of particular sample testing, while others, particularly the international providers, cover a wide range of sample testing. These providers supply testing samples by post or courier, and electronically receive laboratory test results and supply PT outputs. There are no barriers to domestic and international PT providers competing within the general PT services market.

### 3. **Market Definition**

The Applicants consider there are four relevant markets:

- (a) the national tender market for the provision of PT services to the meat industry;
- (b) the national tender market for the provision of PT services to the dairy industry;
- (c) the national tender market for the provision of PT services to the milk industry; and
- (d) the national market for the provision of general PT services, excluding the tender markets referred to above.

### 4. **Counterfactual**

In the counterfactual, the Applicants would not individually be as competitive in the international arena as the merged entity. The net result would be a less effective service to New Zealand laboratories, likely higher costs to the industries and the increased risk that New Zealand PT providers would be uncompetitive, so that services would eventually be provided entirely from offshore, or by offshore-based providers.

### 5. **Competition**

#### ***Tender Markets***

In respect of the meat, dairy and milk markets, the existing PT incumbents have been unchanged since the initial tenders or quasi tenders occurred. Most contracts have been rolled over ever since. In respect of the meat industry, the last tender dates back to 2000 when AsureQuality was AgriQuality and in respect of the dairy industry the last tender round with Fonterra occurred mid-2010 and PSL retained the contract for PT services. In respect

of the milk industry, the last tenders were in 1999 (when PSL was first incorporated) and 2003.

Potential entrants in respect of those tender markets only maintain PT services in respect of the tender markets in which they are the incumbent. However, each has relevant expertise, knowledge and skills enabling them to compete for a tender if it occurs. By their market nature, the total laboratory mass for each tender market becomes immediately available to a successful bidder at which point it gains the ability to win specifically skilled employees from the former incumbent.

The ability to secure a contract for an entire PT programme negates any natural barrier to entry into that market. Regulatory barriers are not considered to be substantial in terms of cost or time required to gain accreditation.

The dominant customer in each tender market has the ability to determine the need for a tender, as demonstrated by Fonterra's recent call for tenders, and the ability and market power to encourage entry by a new PT supplier. This is exactly what occurred in respect of the dairy market, and later the milk market, when PSL won those markets from Agriquality (nowASUREQuality).

### **General PT Services Market**

Because there is only limited crossover in this market and due to the availability of domestic and international Internet-based competition, the Applicants do not consider that the proposed transaction will substantially lessen competition in this market.

## **6. Countervailing Power of Buyers**

In the tender markets, countervailing power lies with the three bodies that respectively have control of the mass of laboratory testing in respect of the meat, dairy and milk industries; the NZFSA, Fonterra and the Raw Milk Laboratories Group (including SAILL and TestLink).

NZFSA contracts PT for the whole of the meat industry. Fonterra is a key influence among the dairy industry's laboratories – it has a number of laboratories of its own and has significant testing contracts with most of the remainder. Laboratories outside Fonterra's direct or indirect influence have insufficient collective mass to sustain an alternative stand-alone programme within New Zealand. SAILL laboratories test 97 percent of New Zealand dairy farm supplier samples and TestLink is also a leading laboratory. Again the remaining laboratories have insufficient mass to support a different programme.

These customers have the knowledge, skill and market power to constrain the incumbent supplier by simply threatening to put their PT services to tender and to encourage a new entrant.

Furthermore, ASUREQuality's principle business (unrelated to this application) is in the provision of laboratory testing services. The PT portion of its business is very small by comparison. Its customers for laboratory services are generally the same as for PT, enabling those customers to use their market power as acquirers in one market to countervail any perceived market power the merged entity (owned as to 60 percent by ASUREQuality) might have in the PT markets.

## **7. No Scope for Tacit Collusion**

The meat, dairy and milk PT markets do not currently display signs of coordinated market power due to the markets being governed by tender.

In the instances where coordinated market power could arise, i.e., at the time of the tender round, the main factors precluding the exercise of coordinated market power are:

- (a) large customers such as the NZFSA, Fonterra and the Raw Milk Laboratories Group are able to detect and punish any attempt to tacitly collude; and
- (b) the absence of price transparency – actual prices are the result of a bid process.

## **8. Conclusion**

The transaction will result in the loss of one of a number of near entrants in each of the three tender markets. It has little impact on the relative market power of both customers and suppliers in each of the three tender markets, and due to the presence of broad local and international Internet- based competition in the general PT Market, does not give rise to a substantial lessening of competition in that market.

## Part 1: Transaction Details

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1. Provide the name of the acquirer (person giving notice), and the name and position of the individual responsible for the notice. Please include the:

- registered office address, postal address and physical address of the acquirer;
- telephone and fax numbers and website of the acquirer; and
- email address, telephone number and position of the contact person.

1.1 This application is jointly made by AsureQuality Limited (**AsureQuality**) and Proficiency Services Limited (**PSL**), directly, or on behalf of a joint venture company yet to be formed, in which AsureQuality and PSL will be the shareholders (the **Applicants**), and which will acquire all of the proficiency testing (**PT**) business assets of AsureQuality and PSL.

1.2 There is information within this application that is confidential as between the Applicants. Although, generally speaking, the Applicants are able to confirm that information specified by the Commerce Commission (the **Commission**) has been supplied, where that information is confidential between the Applicants, one party is unable to confirm the confidential content of the information supplied by the other, i.e., the 'specified' information.

1.3 Both Applicants request that all correspondence is directed in the first instance to:

Bell Gully  
Vero Centre, 48 Shortland Street  
PO Box 4199  
Auckland 1140

|            |                           |                           |
|------------|---------------------------|---------------------------|
| Attention: | Phil Taylor<br>Partner    | Amy Rattray<br>Solicitor  |
| Telephone: | (09) 916 8940             | (09) 916 8642             |
| Fax:       | (09) 916 8801             | (09) 916 8801             |
| Email:     | phil.taylor@bellgully.com | amy.rattray@bellgully.com |

2. Provide the name of the other merger parties, and the name/position of the relevant individual within the relevant merger parties. For each merger party, please include the:

- registered office address, postal address and physical address;
- telephone and fax number and website; and
- email address, telephone number and position of the contact person.

2.1 The participants are AsureQuality and PSL.

**AsureQuality Limited**

Level 4, 8 Pacific Rise  
Mt. Wellington, Auckland

Private Bag 14946  
Panmure, Auckland 1741

Telephone: (09) 573 8000  
Fax: (09) 573 8001  
www.asurequality.co.nz

Contact Person: Udit Singh, Group Manager – Laboratories and Diagnostics

### **Proficiency Services Limited**

Unit 5, 11 Pukete Road  
Te Rapa, Hamilton

PO Box 20474  
Hamilton 3241

Telephone: (07) 850 4483  
Fax: (07) 850 4487  
www.labchek.info

Contact Person: Chris Ingram, Director, Business Development

3. **With respect to the merger parties, list the relevant companies and the person or persons controlling these directly or indirectly. Please use organisational charts or diagrams to show the structure of the ownership and control of the acquirer and participant(s) to the acquisition.**

#### ***Acquirer group***

- 3.1 A new company (**NewCo**) will be formed in which AsureQuality and PSL will be the shareholders. NewCo will acquire all of the New Zealand PT business (including all assets, business contracts and goodwill applicable to the business) of AsureQuality and PSL.
- 3.2 If, following the issue of shares in NewCo, AsureQuality owns less than 60 percent of the shares in NewCo, then contemporaneously with completion of the merger, AsureQuality will acquire from PSL for cash such number of shares in NewCo as will result in AsureQuality owning at completion 60 percent of NewCo shares and PSL owning 40 percent of NewCo shares.
- 3.3 In Australia, AsureQuality will procure that AsureQuality Australia Pty Limited transfers its Australian PT business (including all assets, business contracts and goodwill applicable to the business) to a newly incorporated Australian company (**Australia NewCo**). Australia NewCo will *not* be a subsidiary of NewCo; it is envisaged that AsureQuality Australia Pty Limited will ultimately own 60 percent of Australia NewCo, and PSL, or its nominee (an entity which will be ultimately owned by interests associated with PSL), will own 40 percent of Australia NewCo.

#### ***Target Company group***

- 3.4 AsureQuality is a State-Owned Enterprise.
- 3.5 PSL is jointly owned by Chris and Claire-Lucia Ingram, and Jash Limited. Chris and Claire-Lucia Ingram hold a 50 percent shareholding, as does Jash Limited. Jash Limited is jointly owned by Joanne Bedford and Adrian Coote, with the parties each having a 50 percent shareholding.

**4. Provide details on what is to be acquired.**

4.1 Clearance is jointly sought for AsureQuality and PSL, directly, or on behalf of a joint venture company yet to be formed, in which AsureQuality and PSL will be the shareholders, to acquire all of the PT assets of AsureQuality and PSL in New Zealand (the **Acquisition**).

4.2 The acquired PT assets will include the following:

- (a) assets;
- (b) employees;
- (c) business contracts; and
- (d) goodwill.

4.3 AsureQuality and PSL's physical assets are largely comprised of computer hardware and software, laboratory equipment, chillers, freezers, stocks of samples and packaging, office furniture and equipment. These assets are not significant in relation to the total value of assets; most value is derived from the other assets listed, such as employees, business contracts and goodwill.

**5. Fully explain the commercial rationale for the proposed merger. Specify whether this is part of an international merger.**

***Context***

5.1 AsureQuality and PSL carry on in New Zealand (and to a limited extent overseas) the business of independently assessing the ability of laboratories to competently perform their testing functions. AsureQuality and PSL PT programmes are part of New Zealand's system of laboratory accreditation which supports the acceptance internationally of analytical results from New Zealand laboratories.

***International Competition***

5.2 It is the intent of AsureQuality and PSL to invest in the growth of sufficient mass and expertise to enable the merged entity to effectively compete for the supply of PT services in the international market. Further growth of the market for PT in which AsureQuality and PSL operate is becoming increasingly international, and the success and growth of PT businesses in the factual will be dependant on their competitiveness in international markets.

5.3 In international markets, New Zealand PT products are generally competitive on price and in some cases on quality, yet New Zealand is not a place many international laboratories would look to for expertise in PT. The quality of international competition is growing fast and accreditation requirements of international standards are becoming more demanding.<sup>2</sup> Establishing the necessary credibility requires higher quality products and accreditations, and a higher level of technical capability generally than is currently feasible under the structure and size of the New Zealand PT market.

5.4 Combining the Applicants' assets into a single PT services provider would enable the Applicants to improve their PT services by developing and maintaining a greater

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<sup>2</sup> The current revision process for the International Standardization Organization Guide 43-1 is becoming much more prescriptive and demanding, e.g., ISO/IEC 17043 – the new international standard for PT.



technological expertise that would not be economically viable in two providers of a smaller size.

- 5.5 International providers often have thousands of customers and dozens of employees, representing formidable international competition.<sup>3</sup> Currently, there is a vulnerability associated with the size of each of the Applicants. The merged entity will be less vulnerable and more globally competitive through gaining aggregate levels of staffing and expertise. A combined team of approximately 20 employees will give the merged entity the size needed to sustainably compete internationally and will decrease the uncertainty that can result from losing a key employee, and the exponential effect that this can have in carrying out credible PT services.

#### ***Reliability of testing***

- 5.6 PT programmes require samples to be provided to all customer laboratories in the same industry, enabling them to test for outcomes and report back to the PT provider. The PT provider can then assess the reliability of each laboratory's testing processes by reference to the majority. Where there is insufficient mass of test results from different laboratories, the PT provider cannot reliably determine the accuracy of each laboratory's test results.
- 5.7 By combining the assets of AsureQuality and PSL, the sample size of PT, for industries where there is crossover, will increase significantly. By way of example, although not relevant to this application, the number of participants in the milk powder PT rounds in Australia can be expected to increase by 30 to 50 percent for certain tests. These increases should improve statistical confidence in PT assessments, bringing significant benefits to participants in both the New Zealand and Australian dairy industries. Importantly, there will also be sufficient skilled staff and breadth of industries to enable the effective promotion of PT services of the merged entity into international markets.

#### ***Efficiencies***

- 5.8 Generally, there would be the removal of duplication in head office expenses and business systems e.g., payroll, human resources, financial reporting etc. For information technology systems there would be elimination of duplication in software development, system maintenance, administration and management.
- 5.9 Efficiencies would also occur in the production, testing and distribution of dairy and milk chemistry and microbiology samples (duplicate systems currently supply New Zealand and Australia respectively):
- (a) in microbiology generally – there would be elimination of duplicated capabilities and economies of scale from increased production volumes; and
  - (b) rationalisation of international despatch systems - at present there is duplication of despatches to the same destinations.
- 5.10 See section 27 for further information.

### **6. Provide copies of the final or the most recent versions of any documents bringing about the proposed merger (e.g. contracts, sales and purchase agreements, or offer documents if it is a public bid).**

- 6.1 A copy of the executed heads of agreement between the parties is attached as Appendix 1.

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<sup>3</sup> See Part 5 (competition analysis) for further discussion on this point.

7. **If any other jurisdiction's competition agency has been (or will be) notified of the proposed merger, please list each competition agency notified (or to be notified) and the date of the notification.**

7.1 Not applicable.

- **Please indicate whether you would be willing to provide the Commission with a waiver allowing it to exchange confidential information with competition agencies in other jurisdictions in respect of the proposed merger.**

7.2 Because of the number of participants in the Australian markets, no material aggregation issues arise and consent is not considered necessary.

## Part 2: The Industry

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8. **Describe the relevant goods or services supplied by the merger parties (it is sufficient to refer in general terms to activities in which there will be no aggregation).**
- 8.1 There are a large number of laboratories in different industries requiring PT services. AsureQuality and PSL PT services apply to only a small number of those industries. The principal industries they do supply PT services to are meat, dairy, milk, water and soil.
- 8.2 Relevant to this application, AsureQuality and PSL both carry on in New Zealand the business of independently assessing the ability of laboratories to competently perform their testing functions. PT is generally a quality assessment of laboratories' testing services under which samples are provided by a PT service provider to participating laboratories (the more the better). The laboratories then test the samples and return the test results to the provider.<sup>4</sup>
- 8.3 By virtue of receiving the same or similar results from a large cross section of laboratories, the PT service provider can identify those laboratories which have not reached the same analysis as the majority and which may therefore have inaccuracies in their testing processes. A report is provided to each laboratory comparing their analytical performance with that of the pool of participants in the programme. The greater the sample pool, the higher the degree of certainty with which a PT provider can make an assertion about each laboratory's testing capabilities.
- 8.4 Conversely, a small sample pool renders the PT assessment for each laboratory less dependable – a sufficiency of laboratory mass is essential to provide a reliable PT service.
- 8.5 AsureQuality's New Zealand PT services include:
- (a) Sample programmes on behalf of the New Zealand Food Safety Authority (**NZFSA**):
    - (i) Laboratory Approval Scheme comparative programmes
    - (ii) Sulphonamide onsite programme - evaluation of the proficiency of onsite testers analysing calf blood for chemotherapeutics
  - (b) Chemistry sample programmes:
    - (i) Water chemistry including potable water, chemical residues and effluent water
    - (ii) Meat
    - (iii) Timber preservation
    - (iv) Tallow and edible oil
    - (v) Dairy chemistry including powders, cheese, butter and ice cream
    - (vi) Beverage chemistry including wine, grape juice and fruit juices

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<sup>4</sup> Although some PT can be carried out by the use of 'reference material' samples, the Applicants do not consider this methodology provides an appropriate substitute for third party PT (as described here).

- (c) Microbiology sample programmes:
  - (i) Water microbiology including potable, sea, receiving, effluent and pool water
  - (ii) Meat
  - (iii) Food
  - (iv) Shellfish
  - (v) Pathogens including Salmonella, Listeria monocytogenes, E. coli O157:H7, Campylobacter, Vibrio parahaemolyticus and Cronobacter (Enterobacter) sakazakii
  - (vi) Dairy microbiology including powders, cheese, butter and ice cream
  - (vii) antimicrobials (milk)
  - (viii) BactoScan

8.6 PSL's PT services include:

- (a) 'MilkChek' – PT of client laboratories linked with milk processing facilities
- (b) 'DairyChek' - provides a system for laboratories to validate dairy product testing capability and benchmark their results
- (c) 'LipidChek' – PT for chemical composition and other properties of edible fats and oils
- (d) 'WaterChek' – PT scheme for water chemistry laboratories
- (e) 'SoilChek'/'PlantChek' – PT and soil analysis within Australasia/South East Asia and the Pacific
- (f) 'FertChek' - provides data analysis and interpretation of phosphate fertiliser product testing, which aids in the standardisation of reference methods

8.7 AsureQuality also provides laboratory services to various industries including, for example, the meat, animal health, wine and hospitality industries. Those laboratory services customers who also obtain PT services from AsureQuality are listed in Appendix 4. AsureQuality's food laboratory services business is approximately [●] times the size of its PT services business calculated on a revenue basis.

8.8 AsureQuality laboratory services include:

- (a) Kiestra fully automated microbiology testing system (for products ranging from raw materials through to finished products)
- (b) biosecurity services
- (c) animal health diagnostics
- (d) audit inspection and certification
- (e) food testing

- (f) environmental services
- (g) training solutions

8.9 As noted, AsureQuality is a State-Owned Enterprise. The derivations of AsureQuality are as follows:

- (a) Ministry of Agriculture and Forestry (**MAF**) service delivery, which included PT and laboratory testing, was initially carried out by MAF Quality Management. On 1 July 1995, MAF Quality Management was internally separated from the rest of MAF, pending a review of its functions.
- (b) On 1 November 1998, MAF Quality Management was replaced by two State-Owned Enterprises; Asure New Zealand Limited and AgriQuality Limited (**AgriQuality**).<sup>5</sup> AgriQuality operated all meat, dairy and milk PT services.
- (c) AsureQuality was established as a State-Owned Enterprise on 1 October 2007 from an amalgamation of Asure New Zealand Limited and AgriQuality.<sup>6</sup>
- (d) AsureQuality currently has staff in excess of 1700 in New Zealand, Australia and Singapore.<sup>7</sup> Of those, 11.77 fulltime equivalents are engaged in the provision of PT services.

8.10 PSL was derived from a breakaway by former staff of AgriQuality and MAF Quality Management (predecessors of AsureQuality). In 1999, the Dairy Board encouraged a new entrant, awarding PSL an industry tender for dairy PT services. Since PSL's incorporation in 1999, it has grown to a staff of 7.

**9. Describe the industry or industries affected by the proposed acquisition. Where relevant, describe how sales are made, the supply chain(s) of any product(s) or service(s) involved, and the manufacturing process. If relevant, provide a glossary of terms and acronyms.**

9.1 This application relates to aggregation in PT services markets, and not in laboratory services markets. PSL operates solely in PT services markets. Laboratories are the customers of PT service providers.

9.2 Participation in PT programmes is one means by which a laboratory can assure itself, and others, of its competence in a particular test methodology. Participation in PT may be required and/or sought by regulatory bodies, accreditation bodies, clients of a laboratory, or customers of a manufacturer (where the manufacturer provides test results from an in-house laboratory). As noted earlier, PT results are used by these parties as independent evidence of the competence of a laboratory in a given field of testing.

9.3 PT is also used by regulatory bodies and industry groups to monitor overall performance of particular test methods as applied in laboratories across an industry, for example to ensure that test results are fit for purpose and to identify circumstances where improvements to test methods or laboratory practices are necessary. The overall objective is to ensure that test results from one laboratory (e.g., a manufacturer) will be reproduced within an expected

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<sup>5</sup> Ministry of Agriculture and Forestry. Retrieved 11 October 2010 from [www.maf.govt.nz/mafnet/profile/history/](http://www.maf.govt.nz/mafnet/profile/history/).

<sup>6</sup> Crown Ownership Monitoring Unit. Retrieved 11 October 2010 from [www.comu.govt.nz/asurequality.html](http://www.comu.govt.nz/asurequality.html).

<sup>7</sup> AsureQuality Limited. Retrieved 11 October 2010 from [www.asurequality.co.nz/about-us/company-overview.cfm](http://www.asurequality.co.nz/about-us/company-overview.cfm).

tolerance at any other laboratory (e.g., by a customer or regulatory agency in an importing country).

9.4 For an understanding of the supply chain for PT services, see section 10.

**10. Describe the current industry trends and developments including the role of imports and exports, emerging technologies, and/or changes in supply and demand dynamics.**

10.1 PT services provided by the merged entity to the meat, dairy and milk industries are an extremely important part of the merged entity's business model going forward, and the loss of any of these industries due to non-competitive pricing or servicing would damage the principle objective of the merger – the growth of sufficient mass and expertise to enable the merged entity to compete for the supply of PT services in the international market.

**Context**

10.2 PT services were originally provided to the meat, dairy and milk industries by MAF Quality Management and then AgriQuality. MAF called a tender for a supplier of PT services to all meat testing laboratories in 2000 and AgriQuality won that tender. As noted, AgriQuality eventually becameASUREQuality in 2007.

10.3 The previous incumbent for the provision of dairy related PT services was AgriQuality. When the first tender for dairy related PT services was promoted by the Dairy Board in 1999, PSL won the dairy PT tender. Earlier this year Fonterra Co-operative Group (**Fonterra**) invited ASUREQuality, PSL and an international PT provider to tender for the provision of its PT services. PSL tendered for, and is in the process of finalising, the Fonterra contract for PT services for a period of at least three years.

10.4 When PSL was formed it also launched a milk PT programme. The 'MilkChek' PT scheme was developed to suit the needs of client laboratories, most of which were linked with milk processing facilities, raw milk testing facilities, and contract laboratories throughout New Zealand.<sup>8</sup>

10.5 A group of milk testing laboratories, known as the Raw Milk Laboratories Group collectively negotiated PT terms with PSL. PSL then contracted with them individually and gained sufficient critical mass to become the sole PT provider to the milk testing industry. The contracts have since been renewed by agreement, however, the prospect of collective action by the Group remains a credible threat on PSL (and the merged entity) should the laboratories become unhappy with the PT prices or services offered.

10.6 AgriQuality operated a milk PT scheme for many years. For several years both AgriQuality and PSL provided milk PT programmes until the Raw Milk Laboratories Group switched to PSL's milk PT programme. The Raw Milk Laboratories Group knew that this would collapse AgriQuality's programme, yet it chose to have a single PT services provider.

**Meat Industry**

10.7 A request for tenders for meat PT services was issued by the NZFSA on 10 March 2004. On 15 April 2004, the NZFSA withdrew the request and advised that the situation would be assessed at the end of June 2004. The agreement in place at that time was extended to 30 June 2004 (as it was to expire in April 2004). The agreement was then extended from 2004 through to 2007 on a yearly basis. ASUREQuality's current contract with the NZFSA

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<sup>8</sup> Proficiency Services Limited. Retrieved 11 October 2010 from [www.labchek.info/milkchek.php](http://www.labchek.info/milkchek.php).

commenced on 1 July 2007. It is understood that the contract has been extended to the end of November 2010, after which the NZFSA intends to tender its meat PT programme.

### ***Dairy Industry***

- 10.8 In 1999 a tender for the provision of dairy related PT services was led by the Dairy Board, but PSL contracted individually with the dairy companies. All dairy companies (representing about eighty percent of dairy laboratories) acted collectively as part of this tender process. The then existing provider (AgriQuality) had insufficient participants and therefore mass to enable its programme to remain viable, consequently, the remaining laboratories also contracted with PSL.
- 10.9 Since the initial tender round, there has been renewal of the resulting contracts by agreement, excepting the Fonterra tender round earlier this year.<sup>9</sup>
- 10.10 For dairy laboratories to be International Accreditation New Zealand (**IANZ**) accredited, they need to participate in PT programmes. PSL provides PT services to the entire dairy industry, however, should a participant such as Fonterra decide to join another PT programme, PSL would lose the critical mass needed for its PT programmes and other laboratories would almost certainly follow Fonterra to a new PT supplier. Laboratories need consistent benchmarking of results and most dairy laboratories desire to be in the same PT programme as Fonterra.

### ***Milk Industry***

- 10.11 There are approximately 20 laboratories testing milk in New Zealand. Most of these laboratories are accredited by IANZ and are required to participate in some form of PT programme for milk testing.
- 10.12 The major New Zealand milk testing laboratories selected a single supplier of PT services through the Raw Milk Laboratories Group. Members of the Group included SAITL Dairy Laboratory (**SAITL**) and TestLink Analysis (**TestLink**).
- 10.13 SAITL is one of New Zealand's largest group of milk testing laboratories. SAITL tests milk samples taken from farmer suppliers by dairy companies, the results of which are used to calculate the payment to the farmers. Over 97 percent of New Zealand dairy farm supplier samples are tested by SAITL.<sup>10</sup> In terms of volume, SAITL tests more than five million milk samples each year.
- 10.14 TestLink is owned by LIC (Livestock Improvement Corporation Limited).<sup>11</sup> TestLink analyses milk for LIC's herd testing services. It tests more than 10 million milk samples each year.
- 10.15 Laboratories need consistent benchmarking of results and most would prefer to be in the same PT programme as the Raw Milk Laboratories Group (including SAITL and TestLink). Laboratories outside the Raw Milk Laboratories Group would have insufficient collective mass to sustain an alternative stand-alone programme. SAITL and TestLink's leadership in milk testing gives the Raw Milk Laboratories Group countervailing power in the milk PT market. They have the knowledge, skill and market power to constrain the incumbent

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<sup>9</sup> See paragraph 10.3.

<sup>10</sup> South Auckland Independent Testing Society Limited. Retrieved 11 October 2010 from [www.saitl.co.nz/about-us/about-us\\_3.htm](http://www.saitl.co.nz/about-us/about-us_3.htm).

<sup>11</sup> Livestock Improvement Corporation Limited. Retrieved 11 October 2010 from [www.lic.co.nz](http://www.lic.co.nz).

supplier by simply threatening to put their PT services to tender and to encourage a new entrant.

**11. Please highlight any relevant mergers that have occurred in this industry over the past three years. Include:**

- **any acquisition of assets of a business or shares which the merger parties (or any interconnected or associated businesses) have undertaken in the last three years.**

11.1 Because of economies of scale, the globalisation of markets in scientific services internationally and the increasingly stringent requirements of PT customers, there has been a trend of consolidation in the global PT industry.

11.2 For example LGC Limited (**LGC**), based in the United Kingdom, acquired Quality Management Limited (**Quality Management**) and AquaCheck in 2005. Quality Management provided PT schemes in microbiology and chemistry for the United Kingdom meat, dairy, food, and environmental industries, whilst Aquacheck provided PT schemes for the water and environmental testing markets. LGC managed a number of PT schemes, covering a varied industry base including brewing, distilling, food, environment, forensic and consumer safety (e.g., toys). The combined operation encompassed over 4000 participating laboratories from across the world to become a major international provider of PT services.<sup>12</sup>

11.3 In New Zealand, PSL acquired IANZ's PT assets in 2003 including the 'WaterTest' water chemistry programme, now branded 'WaterChek'.

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<sup>12</sup> See paragraph 16.10 for further information.



## Part 3: Market Definition

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### HORIZONTAL AGGREGATION

12. For each area of aggregation of market shares, please define the relevant market(s) for the:

- product(s) or service(s);
- functional level;
- geographic area; and
- customer dimension and timeframe (if relevant).

12.1 The principal industries requiring PT services in New Zealand are meat, dairy and milk. Each industry is supplied by one PT services provider. In respect of PT services pertaining to all other industries, the market is globally competitive.

12.2 See paragraphs 10.2 to 10.6 for further information.

12.3 There is no aggregation in respect of laboratory services. PSL does not carry on a business which supplies or operates laboratory services.

12.4 The Acquisition will give rise to aggregation in respect of PT services.

#### ***Market Overview***

12.5 Within the meat, dairy and milk industries, the provision of PT services commences with a tender, although general satisfaction with pricing, service and terms means that when each original tender term ends, there is a rollover rather than a re-tender. Nevertheless the obvious threat of a re-tender remains as a constraint on the current holder of the contracts for supply of PT services to each of those industries.

12.6 Because of the need for critical mass, whichever PT provider the dominant customer or group of customers choose, all other customers will need to contract with that provider. This demonstrates that the real market power lies with the major customer/s within the various industries rather than with the provider of PT services. The major customers in each industry include:

- (a) NZFSA in the meat industry;
- (b) Fonterra in the dairy industry; and
- (c) The Raw Milk Laboratories Group (including SAITL and TestLink) in the milk industry.

#### ***Market Definition***

12.7 Broadly, the market on the supply side is the market for the provision of PT services. This covers PT services for a wide range of industries including, by way of example only, the meat, dairy, milk, water, soil and fats and oils industries. Because there are no transportation, geographic or timing limitations on provision of these services, in each case it is a national market. Testing samples are generally sourced from all over the country and

sent to each relevant industry laboratory for testing. Results and reports are normally made available electronically to customers. Neither the locality of any particular customer nor the locality of the laboratory is of any particular advantage, therefore the Applicants believe the market is national in nature, and no local or regional markets exist.

- 12.8 In fact, in respect of the supply of general PT services, it is a global market; international providers supply services in the New Zealand market and to a lesser degree,ASUREQuality and PSL also operate in international markets, particularly in Australia.
- 12.9 In respect of the meat industry, there is one contract for PT services entered into by the NZFSA on behalf of the entire industry. The NZFSA tenders for provision of PT services to the entire meat industry and contracts for that supply. The NZFSA then charges each user in accordance with its proportion of the cost of the overall service.
- 12.10 In respect of the dairy industry, a tender for PT services was led by the Dairy Board (now part of Fonterra). Eighty percent of the dairy industry participated in the tender, however, as the remaining companies needed to partake in a PT programme with sufficient critical mass and needed their standards to equate to those of the dominant leader, Fonterra, the tender round encompassed the entire industry. Since the initial tender round in 1999, there has been renewal by agreement with all dairy participants, excepting the Fonterra tender round earlier this year.
- 12.11 In the milk testing industry, the Raw Milk Laboratories Group collectively negotiated PT terms with potential providers. PSL contracted with individual laboratories and gained sufficient critical mass to become the sole PT provider to the milk industry. The contracts have since been renewed by agreement (having been led by SAITL and TestLink which, by virtue of their milk testing volumes, have countervailing market power); however, the prospect of collective action by the Group remains a credible threat on PSL and the merged entity.
- 12.12 When prices are reviewed, the Applicants consider previous prices, changes in costs (including any changes in the service required) and changes in volume. Expectations of price from previous negotiations or contracts constrain the Applicants when setting price. Changes to the quality or scope of the PT service required also affect prices. The Applicants are both aware of international competition, particularly for international clients who, by participating in the Applicants' PT programmes, have already shown a willingness to look to global markets for what they need.
- 12.13 In the counterfactual, price setting would be the same as above. In the factual, price setting for the merged entity would be based on the same factors as above, but with a lower cost structure.
- 12.14 The Applicants consider that in respect of the meat, dairy and milk industries there are markets for the provision of PT services, where competition arises only when a new tender is available – a tender for the market in each case.
- 12.15 The Commission has considered tenders for the market in respect of a number of industries and usually analyses the impact on competition over a time dimension for the market that best exposes the impact of the proposed merger at the point in time at which it would have effect.
- 12.16 In its analysis of a proposed business acquisition involving New Zealand Diagnostic Group Ltd and Sonic Healthcare (New Zealand) Ltd (**NZDG**),<sup>13</sup> the Commission considered whether

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<sup>13</sup> Commerce Commission Decision No. 559, 29 September 2005.

the transaction was likely to affect competition at the point where competition occurs (i.e., when the parties bid for contracts).

- 12.17 In this case, competition occurs *for* the market rather than *in* the market. In NZDG, that point in time occurred when the contracts were next tendered. The proposed term of each contract varied by region. Thus, the Commission considered the competitive effects of the proposed acquisition over ten years for Otago/Southland, five years for South Canterbury and Hawkes Bay, and three to five years for Canterbury and the West Coast.
- 12.18 The Commission took the same approach in the application for clearance of a proposed business acquisition involving Valley Diagnostic Laboratories Limited and Wellington Pathology.<sup>14</sup> Again, the Commission considered the impact of the proposed merger at the point in time at which it would have effect, which is when pathology contracts were next to be awarded. In that case the proposed contract term was five years. Thus, the Commission analysed competition at the current point in time (the current contract round) as well as in five years' time (the next contract round).
- 12.19 The Applicants consider, that in the context of how the Commission defines a market, there are four markets pertinent to this application:
- (a) the national tender market for the provision of PT services to the meat industry;
  - (b) the national tender market for the provision of PT services to the dairy industry;
  - (c) the national tender market for the provision of PT services to the milk industry; and
  - (d) the national market for the provision of general PT services, excluding the tender markets referred to above.
- 12.20 However, the Applicants do not consider that a great deal depends on how the market is defined because in respect of the segments relating to the meat, dairy and milk industries, the competition analysis revolves around:
- (a) the fact that competition only exists at the time when industry participants decide to go to tender;
  - (b) the contracts are entered into for a term;
  - (c) the fact that the provision of credible PT services requires there to be a sufficient mass of testing laboratories, accordingly, there can only be one supplier of PT services to each industry;
  - (d) the industry participants see benefits in, and support, having one PT services supplier for their industry;
  - (e) the industry customers have the countervailing power to ensure that the terms and prices for supply remain competitive; and
  - (f) it is in the hands of the industry to determine whether to encourage and support new entry (as the dairy industry did when PSL was formed).
- 12.21 It is of note that both the meat industry (NZFSA) and the dairy industry (Fonterra) have indicated their support for this transaction on the basis that it will give rise to efficiencies to

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<sup>14</sup> Commerce Commission Decision No. 572, 31 January 2005.

their benefit and because they have no concerns that the merged entity will be able to exercise market power which the industries cannot countervail. Fonterra and the dairy industry's current practice demonstrates this lack of concern, in that they only engage one PT services provider for a term; in most areas of Fonterra's business, it is more common to have two suppliers for any one service, however one PT service provider is a natural consequence of the market in which PT service providers operate. Credible sample testing requires a broad mass of test results.

- 12.22 The NZFSA has deferred its tender for meat PT services until November 2010 in order to allow the Acquisition to complete. Fonterra has recently tendered its contract for dairy PT services and the resulting successful tender by PSL, and its terms, have also rolled into the remaining dairy PT contracts.
- 12.23 With the exception of milk, New Zealand's quarantine restrictions are not sufficiently costly or onerous to be a significant barrier to entry for offshore providers; therefore local participants are constrained by the supply of PT services from overseas as well as locally. The provision of these services by overseas participants is characterised by low barriers to entry, the ease with which samples can be provided by post, the use of instant response Internet-based results delivery by each laboratory and Internet response from the PT services supplier. Indeed the overseas suppliers of these certification services have the advantage of a considerably wider range of samples against which to base their PT comparisons.
- 12.24 Note that of all PT programmes except water chemistry and fats and oils, AsureQuality and PSL do not compete on a daily basis. Competition in water chemistry is available from many international providers including LGC Standards,<sup>15</sup> Environmental Resource Associates<sup>16</sup> and Proficiency Testing Australia,<sup>17</sup> or possibly from a local new entrant such as Environmental Laboratory Services.<sup>18</sup> In terms of fats and oils, international providers such as the American Oil Chemists' Society<sup>19</sup> represent a significant competitive constraint.
- 12.25 For all other general PT services, direct competition would not be affected by the Acquisition, and near-competition would be provided by international providers.

**13. Where relevant, please explain how products or services are differentiated within the market(s).**

- 13.1 The PT services market is differentiated based on the PT programmes and the industries within which the PT programmes operate. However, from the supply side, the PT skills that apply with regard to one industry can generally be applied across the overall PT services market, such that any party with the relevant skills (or the ability to gain the relevant skills) is a competitor, or near competitor.
- 13.2 Relevant PT programmes are listed at paragraphs 8.5 to 8.6.
- 13.3 The meat, dairy and milk industries represent the major PT programmes in New Zealand. The remaining PT services are and will remain extremely competitive due to the fact that

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<sup>15</sup> See paragraphs 11.2 and 16.10.

<sup>16</sup> See [www.eraqc.com](http://www.eraqc.com).

<sup>17</sup> See [www.pta.asn.au](http://www.pta.asn.au).

<sup>18</sup> See paragraph 16.16.

<sup>19</sup> See [www.aocs.org](http://www.aocs.org).

they operate as open, competitive markets, with no limitation on engaging any international supplier of PT services at competitive rates of supply.

- 13.4 While requirements are different for each programme, in general terms, a PT round involves the following two major areas of work - sample preparation, storage and despatch; and the receipt and evaluation of results for reporting.

## **VERTICAL INTEGRATION**

14. **Provide details of any creation or strengthening of vertical integration that would result from the proposed merger. Please use organisational charts or diagrams to illustrate the structure of the ownership and/or control of the participants and the vertical relationships in question.**

- 14.1 The Acquisition will not result in any change in vertical integration.

## Part 4: Counterfactual

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- 15. In the event that the proposed merger does not take place, describe what is likely to happen to the business operations of the merger parties and the market/industry.**
- 15.1 Given low barriers to entry and expansion, the Applicant believes that new entry, exit, and mergers and acquisitions would continue in the industry over time. Subject to the view expressed in paragraph 15.3, the status quo would be maintained.
- 15.2 The current PT providers are not likely to change in the short term, unless one of the providers reduces service levels or increases pricing, or otherwise loses international credibility. Customer laboratories have been satisfied with the Applicants' service and pricing levels, accordingly, there has been a tendency for PT services tender contracts across the meat, dairy and milk industries to be rolled over.
- 15.3 AsureQuality and PSL could continue to pitch for each other's tenders when bids are invited. However, if the meat, dairy or milk industry contracts were to switch from AsureQuality to PSL, or vice versa, then the PT programmes would be operated by the same entity. The other PT provider would suffer a significantly weakened competitive position and would potentially cease to be viable. With their current small size and staff, both are vulnerable to the loss of key staff members.
- 15.4 In the counterfactual, both companies could seek to grow internationally, for example AsureQuality could start a PT programme in Asia using the Singapore Laboratory as a base, but they would not individually be as competitive in the international arena as the merged entity. Each existing entity could seek to align with major international providers, but again individually would not be in as strong a bargaining position as the merged entity. The net result would be a less effective service to New Zealand laboratories, likely higher costs to the industries and the increased risk that New Zealand PT providers would be uncompetitive, so that services would eventually be provided entirely from offshore, or by offshore-based providers.
- 15.5 Local representation of major international providers is likely to occur at some point. Loss of participants to offshore providers could make some local programmes unviable.
- 15.6 The Applicants' laboratory customers are listed in Appendix 4.

## Part 5: Competition Analysis

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### EXISTING COMPETITORS

16. Identify all of the relevant competitors in the market(s), including near competitors and importers in the market(s), and describe how they all compete in the market(s).

16.1 In respect of the meat, dairy and milk industries there is only one provider of PT services during any operational period due to the need for laboratory critical mass. Accordingly, for those tender markets there are only near competitors. However, in respect of general PT services, there is existing competition.

16.2 In the meat and dairy industries, the merged entity would be constrained by the threat of competition from overseas PT providers. This is illustrated by the fact that when the NZFSA and Fonterra call for tenders, international providers are invited to participate. Conversely, the shelf life of raw milk and quarantine requirements combine to make the importation of milk samples impractical.

#### ***Near Competitors (Meat PT)***

16.3 New Zealand Laboratory Services

(a) New Zealand Laboratory Services Limited (**New Zealand Laboratory Services**) provides vital testing support across most sections of the New Zealand food manufacturing industry.<sup>20</sup> It is ultimately owned by Amdel Limited, a member of the Bureau Veritas Group. Bureau Veritas isASUREQuality's largest competitor in the laboratory services market.

(b) New Zealand Laboratory Services has many of the specialist skills necessary to develop and provide meat chemistry and microbiology PT programmes, as well as established relationships with clients in the meat industry and the relevant regulatory authorities.

(c) New Zealand Laboratory Services provides the following services:

- (i) food testing;
- (ii) dairy and meat testing;
- (iii) seafood testing;
- (iv) chemistry; and
- (v) microbiology.

16.4 IFM Quality Services

(a) IFM Quality Services Pty Limited (**IFM Quality Services**) is an Australian company that specialises in laboratory quality assurance. It provides services to a diverse

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<sup>20</sup> New Zealand Laboratory Services Limited. Retrieved 11 October 2010 from [www.nzlabs.co.nz/Company\\_Food.htm](http://www.nzlabs.co.nz/Company_Food.htm).

range of organisations, including accreditation bodies, regulatory authorities, government agencies and private companies.<sup>21</sup>

- (b) IFM Quality Services provides a number of PT programmes in food microbiology that meet most of the requirements for the meat and dairy industries.
- (c) IFM Quality Services provides assistance to laboratories by improving and maintaining the quality of their analyses through the provision of laboratory quality assurance products and services. Its primary products and services include:
  - (i) PT programmes;
  - (ii) reference materials; and
  - (iii) consulting services.
- (d) IFM Quality Services also offers custom designed PT programmes. A group of laboratories or staff within a company with a particular PT need can approach IFM Quality Services about designing a custom programme for their use. IFM Quality Services states that it has a wide variety of products that could be combined to produce a PT programme to fit the needs and budget of many laboratories.<sup>22</sup>
- (e) The Institute of Environmental and Scientific Research (**ESR**) participates in an IFM Quality Services PT programme for general food microbiology.

## 16.5 FAPAS

- (a) FAPAS is part of The Food and Environment Research Agency, an executive agency of the United Kingdom Government Department for Environment, Food and Rural Affairs.<sup>23</sup>
- (b) FAPAS is accredited by the United Kingdom Accreditation Service. FAPAS' services are supported by a network of agents worldwide. A local agent takes orders and responds to enquiries.
- (c) FAPAS offers products that could substitute for the meat PT programmes offered by AsureQuality and the dairy PT programmes offered by PSL.

### ***Near Competitors (Dairy PT)***

## 16.6 Fonterra

- (a) Fonterra is the world's leading exporter of dairy products and is responsible for more than a third of international dairy trade.<sup>24</sup> Moreover, Fonterra provides services in dairy innovation and technology.

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<sup>21</sup> IFM Quality Services Pty Limited. Retrieved 11 October 2010 from [www.ifmqs.com.au/intro.htm](http://www.ifmqs.com.au/intro.htm).

<sup>22</sup> IFM Quality Services Pty Limited. Retrieved 11 October 2010 from [www.ifmqs.com.au/other%20products%20and%20services.htm](http://www.ifmqs.com.au/other%20products%20and%20services.htm).

<sup>23</sup> The Food and Environment Research Agency. Retrieved 11 October 2010 from [www.fapas.com/index.cfm](http://www.fapas.com/index.cfm).

<sup>24</sup> Fonterra Co-operative Group. Retrieved 11 October 2010 from [www.fonterra.com](http://www.fonterra.com).



- (b) Fonterra currently operates a weekly dairy chemistry PT programme to support the calibration of testing instruments and produces its own reference quality control samples. It has, or can have, access to all the necessary technical and physical resources to set up and run in-house PT programmes in dairy and microbiology. It has the necessary laboratory testing mass to support its own PT business. Without Fonterra's participation in the industry-wide dairy PT programme, PSL would lose its critical mass and would not be able to credibly service the remainder of the dairy industry.

#### 16.7 New Zealand Laboratory Services

- (a) The Hamilton branch of New Zealand Laboratory Services currently prepares micro cultures and performs verification testing for PSL's dairy and milk microbiology programmes. New Zealand Laboratory Services has many of the necessary specialist skills needed to develop and provide dairy and milk chemistry and microbiology PT programmes.
- (b) See paragraph 16.3 for further information.

#### 16.8 IFM Quality Services

- (a) See paragraph 16.4.

#### 16.9 FAPAS

- (a) See paragraph 16.5.

#### 16.10 LGC Standards

- (a) LGC Standards is a major international provider of PT services. Operating from a site in the United Kingdom at Bury, Lancashire, the PT business encompasses over 6,000 participating laboratories in more than 130 countries.<sup>25</sup>
- (b) With over twenty years' experience in all aspects concerned with the provision of PT services, LGC Standards offers a wide range of solutions to laboratories undertaking chemical, microbiological and physical analysis, including quality training programmes.
- (c) The Applicants believe LGC Standards could supply the New Zealand market with PT services. It has a strong international presence and brand recognition among New Zealand laboratories.
- (d) LGC offers dairy chemistry and microbiology PT programmes which could be substituted for dairy programmes provided by PSL.

#### ***Near Competitors (Milk PT)***

#### 16.11 SAITL Dairy Laboratory

- (a) SAITL operates a weekly calibration service for milk testing labs. Over 97 percent of New Zealand dairy farm supplier samples are tested by SAITL.<sup>26</sup>

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<sup>25</sup> LGC Limited. *Proficiency Testing Catalogue* at 4. Retrieved 11 October 2010 from [www.lgcpt.com](http://www.lgcpt.com).

<sup>26</sup> Above n10.

- (b) In addition to supplier testing, SAITL performs a range of chemical and microbiological raw milk testing for member companies, non-member dairy companies and other dairy industry groups such as Quality Consultants New Zealand Limited, Dairy New Zealand and veterinarians.
- (c) SAITL has the experienced staff, market recognition and physical resources necessary to provide milk chemistry and microbiology PT programmes.

#### 16.12 New Zealand Laboratory Services

- (a) See paragraphs 16.3 and 16.7.

#### ***Existing Competitors (General PT)***

#### 16.13 WEPAL

- (a) A PT group called Wageningen Evaluating Programmes for Analytical Laboratories (**WEPAL**) is located in Bennekom, the Netherlands. WEPAL's PT schemes contribute to maintaining and improving the quality of laboratories that specialise in soil quality and related fields.<sup>27</sup>
- (b) WEPAL provides the following testing schemes:
  - (i) plant programmes;
  - (ii) soil programmes;
  - (iii) sediment programmes;
  - (iv) manure programmes; and
  - (v) biomass programmes.
- (c) WEPAL already provides high quality PT programmes to more than 500 participants internationally, including a number from Australia and New Zealand.
- (d) WEPAL provides PT programmes for soil and plants to several New Zealand laboratories, in direct competition with PSL's programmes. Hill Laboratories, Analytical Research Laboratories and Veritec Laboratories participate in WEPAL programmes for soil and plant material testing.

#### ***Near Competitors (General PT)***

#### 16.14 LGC Standards

- (a) See paragraph 16.10.

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<sup>27</sup> Wageningen Evaluating Programmes for Analytical Laboratories. Retrieved 11 October 2010 from [www.wepal.nl](http://www.wepal.nl).

#### 16.15 The Institute of Environmental and Scientific Research

- (a) ESR is a government-owned Crown Research Institute. ESR provides science advice and services to government agencies, local authorities and the private sector.<sup>28</sup>
- (b) ESR provides the following services:
  - (i) science provider to the NZFSA, New Zealand Customs, Medsafe, Pharmac and the Department of Corrections;
  - (ii) science partner of MAF Biosecurity; and
  - (iii) science advisor for local authorities, industry organisations and the private sector.
- (c) ESR would be capable of delivering microbiological programmes or a water chemistry programme. ESR's staff worked on development and delivery of PSL's 'WaterTest' programme when the programme was run by the Department of Scientific and Industrial Research.
- (d) ESR has previously indicated to bothASUREQuality and PSL that it would be interested in expanding its PT business. In 2004 ESR agreed to join with PSL to tender for NZFSA's meat PT contract, although that tender did not proceed due to NZFSA's ongoing research and development projects with AgriQuality. ESR is recognised for its expertise in food safety and for its testing capability in the food industry, but its PT capability is less widely known.

#### 16.16 Environmental Laboratory Services

- (a) Environmental Laboratory Services (**ELS**) is an IANZ approved, Laboratory Approval Scheme and Ministry of Health approved testing laboratory based in Lower Hutt, New Zealand. ELS offers a broad range of microbiological and inorganic chemistry analyses, covering a large range of sample matrices.<sup>29</sup>
- (b) ELS is accredited to perform the following tests:
  - (i) microbiological testing of foods;
  - (ii) metal testing of foods;
  - (iii) chemical testing of foods; and
  - (iv) dairy testing services.
- (c) ELS prepares samples, delivers testing services and provides technical support to PSL's 'WaterTest' water chemistry programme. ELS has very experienced and skilled staff and would be capable of delivering a water chemistry PT programme.

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<sup>28</sup> The Institute of Environmental and Scientific Research. Retrieved 11 October 2010 from [www.esr.cri.nz/Pages/default.aspx](http://www.esr.cri.nz/Pages/default.aspx).

<sup>29</sup> Environmental Laboratory Services. Retrieved 11 October 2010 from [www.els.co.nz](http://www.els.co.nz).

17. Outline the estimated market shares in terms of sales, and, where relevant, volume and productive capacity, of the merger parties and competitors identified above. Please include:

- the estimated total value of the domestic market; and
- the source of the data provided.

***The Tender Market for the Provision of PT services to the Meat Industry***

| RANK | COMPETITORS (INCLUDING MERGER PARTIES) | ESTIMATED REVENUE | ESTIMATED % OF MARKET SHARE BY REVENUE | ESTIMATED VOLUME | ESTIMATED % OF MARKET SHARE BY VOLUME |
|------|--|-------------------|--|------------------|---------------------------------------|
| 1    | AsureQuality                           | [●]               | [●]                                    | [●]              | [●]                                   |

SOURCES OF ESTIMATES: AsureQuality’s knowledge based on industry contract.

***The Tender Market for the Provision of PT services to the Dairy Industry***

| RANK | COMPETITORS (INCLUDING MERGER PARTIES) | ESTIMATED REVENUE | ESTIMATED % OF MARKET SHARE BY REVENUE | ESTIMATED VOLUME | ESTIMATED % OF MARKET SHARE BY VOLUME |
|------|--|-------------------|--|------------------|---------------------------------------|
| 1    | PSL                                    | [●]               | [●]                                    | [●]              | [●]                                   |

SOURCES OF ESTIMATES: PSL’s knowledge based on industry contracts.

***The Tender Market for the Provision of PT services to the Milk Industry***

| RANK | COMPETITORS (INCLUDING MERGER PARTIES) | ESTIMATED REVENUE | ESTIMATED % OF MARKET SHARE BY REVENUE | ESTIMATED VOLUME | ESTIMATED % OF MARKET SHARE BY VOLUME |
|------|--|-------------------|--|------------------|---------------------------------------|
| 1    | PSL                                    | [●]               | [●]                                    | [●]              | [●]                                   |

SOURCES OF ESTIMATES: PSL’s knowledge based on industry contracts.

***The Market for the Provision of General PT services***

| RANK | COMPETITORS (INCLUDING MERGER PARTIES) | ESTIMATED REVENUE | ESTIMATED % OF MARKET SHARE BY REVENUE | ESTIMATED VOLUME | ESTIMATED % OF MARKET SHARE BY VOLUME |
|------|--|-------------------|--|------------------|---------------------------------------|
| 1    | AsureQuality                           | [●]               | [●]                                    | [●]              | [●]                                   |
| 2    | PSL                                    | [●]               | [●]                                    | [●]              | [●]                                   |

SOURCES OF ESTIMATES: Applicants’ estimates based on industry contracts.

- 17.1 Neither AsureQuality or PSL can accurately determine their market share in respect of general PT services. The figures set out in the sub-paragraphs below are their estimates:
- (a) PSL's revenue from water chemistry is [●]. PSL's market share in water chemistry is between [●] and AsureQuality is its main competitor. AsureQuality's revenue in water chemistry is estimated at [●]. International providers make up 10 to 20 percent of the market.
  - (b) PSL also competes with AsureQuality in PT for fats and oils – PSL's revenue is approximately [●]. PSL estimates that it has a [●] market share.
  - (c) PSL's revenue from soil and plant testing is [●] and its market share is approximately [●]. More than 80 percent of the other PT laboratories in this market are international. AsureQuality does not offer an equivalent PT service. WEPAL is PSL's major competitor here.
  - (d) The remainder of PSL's general PT services revenue is approximately [●] and is in areas where PSL does not compete with AsureQuality.

18. **To what extent do you consider that the merged entity would be constrained in its actions by the conduct of existing competitors in the markets affected? Where relevant please include a full discussion and examples of:**

- **the ease with which customers may switch between suppliers, and, if so, how readily**

***The Tender Market for the Provision of PT services to the Meat Industry***

- 18.1 The NZFSA has the ability to constrain a provider of a meat PT programme through its size, the availability of alternative sources of supply, the ability to collectively switch providers, or the ability to foster new supply by supporting a new entrant with a long term contract. A provider contracts with the NZFSA for the provision of PT services to the entire meat industry, accordingly, the NZFSA has the power to encourage another PT provider. Whether or not there is to be a re-tender is in the hands of the NZFSA; until then the industry contract renews by agreement.
- 18.2 The threat of a re-tender, or alternatively, the threat that the NZFSA will encourage another PT provider to tender (by way of guaranteed terms etc.) is what will constrain the merged entity. If the contract is lost then effectively a major source of the merged entity's revenue source will be permanently lost until the next tender.

***The Tender Market for the Provision of PT services to the Dairy Industry***

- 18.3 As with the meat industry, Fonterra has the ability to constrain a supplier of a dairy PT programme through the availability of alternative sources of supply, the ability to collectively switch providers, or the ability to foster new supply either by supporting a new entrant with a long term contract or establishing its own industry programme. This countervailing power was clearly demonstrated when Fonterra invited tenders for its PT contract earlier this year.
- 18.4 The threat that Fonterra will encourage another PT provider, such as IFM Quality Services, to tender (by way of guaranteed terms etc.) is what will constrain the merged entity.
- 18.5 Alternatively dairy customers may choose to perform their PT services in-house ('own-supply'). Examples of 'own-supply', indicating the competence and scale of existing capability within the industry, include Fonterra. Fonterra operates its own in-house PT programme where they are unable to find a suitable service/price package in the market, or where it is cost-effective to do so.

- 18.6 By way of example, Fonterra operates a calibration ring test (an internal PT programme) to compare dairy chemistry results from their calibration system for milk powder and other products with results from the same samples tested by reference methods in their main laboratories. Because it runs weekly (and PT programme frequency is alternate monthly) this programme is larger (in terms of sample numbers) than the industry-wide 'DairyChek' PT programme. Any future provider would be aware of the threat that Fonterra could operate its own in-house PT programme if it was unable to find a suitable service/price package in the market. Once a customer such as Fonterra is encouraged to 'own-supply', it is highly unlikely that its business will again be available to PT competitors.

***The Tender Market for the Provision of PT services to the Milk Industry***

- 18.7 The Raw Milk Laboratories Group has the ability to constrain a supplier of a dairy PT programme through the availability of alternative sources of supply, the ability to collectively switch providers, or the ability to foster new supply either by supporting a new entrant with a long term contract or establishing their own industry programme.
- 18.8 PSL collectively negotiates terms with the Raw Milk Laboratories Group, but contracts with each laboratory individually. When PSL was formed in 1999, it launched and promoted its milk PT programme. At the time, most milk testing laboratories were in AgriQuality's PT programme. The Raw Milk Laboratories Group invited PSL to present a proposal and accepted its terms. AgriQuality did not have enough critical mass to sustain its milk PT programme and terminated it. This illustrates the ease with which milk testing laboratories may switch suppliers, especially with the presence of strong near competitors such as New Zealand Laboratory Services and the effect on a supplier's business long term if a programme is lost.
- 18.9 Milk testing laboratories need consistent benchmarking of results; for farmer payments, for herd testing (livestock selection and breeding) and for the sale of milk products between companies. Therefore milk testing laboratories would prefer to be in the same PT programme as SAITL and TestLink (the Raw Milk Laboratories Group). Furthermore, laboratories outside the Raw Milk Laboratories Group would have insufficient collective mass to sustain an alternative stand-alone PT programme. Should SAITL, TestLink or other milk testing laboratories become unhappy with the service or price offered by the merged entity, they could collectively seek another PT provider by way of the Raw Milk Laboratories Group.

***The Market for the Provision of General PT services***

- 18.10 In terms of general PT services, such as water, soil, fats and oils, etc., there is a ready availability of Internet-based PT testing from overseas competitors such as WEPAL and LGC Standards. Samples are able to be sent by post without any limitation. Hill Laboratories, Analytical Research Laboratories and Veritec Laboratories participate in WEPAL programmes for soil and plant material testing.
- 18.11 The market for general PT services operates on a short-term contract basis and there are many existing competitors. Consequently, should prices increase, or the quality of PT services fall, customers could switch to another PT service provider by entering into a new contractual arrangement.

- any local or overseas firms that are not currently producing the product, or providing the service in the market, but could enter the market quickly (using essentially their existing productive capacity) in a response to an attempt by suppliers to raise prices or reduce output or quality (near competitors and importers)

18.12 In the meat, dairy and milk industries, all competitors are near entrants until such time as a tender occurs. Competition exists in the ability of a new PT provider to establish themselves should an inducement to do so emerge. Such an organisation could establish itself with the support of customers.<sup>30</sup> This is discussed further in paragraphs 18.26 to 18.32. Near entrants are identified and discussed in section 16 of this application.

***The Tender Market for the Provision of PT services to the Meat Industry***

18.13 New Zealand Laboratory Services

(a) See paragraph 16.3.

18.14 IFM Quality Services

(a) See paragraph 16.4.

18.15 FAPAS

(a) See paragraph 16.5.

***The Tender Market for the Provision of PT services to the Dairy Industry***

18.16 Fonterra

(a) See paragraph 16.6.

18.17 New Zealand Laboratory Services

(a) See paragraphs 16.3 and 16.7.

18.18 IFM Quality Services

(a) See paragraph 16.4.

18.19 FAPAS

(a) See paragraph 16.5.

18.20 LGC Standards

(a) See paragraph 16.10.

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<sup>30</sup> The example of PSL's entry into the PT services market in 1999 is a good indication of the means by which entry might occur by a start-up. Establishment required an investment of between \$150,000 to \$200,000 and the process took less than six months.

***The Tender Market for the Provision of PT services to the Milk Industry***

18.21 SAITL Dairy Laboratory

(a) See paragraph 16.11.

18.22 New Zealand Laboratory Services

(a) See paragraphs 16.3 and 16.7.

***The Market for the Provision of General PT services***

18.23 LGC Standards

(a) See paragraph 16.10.

18.24 The Institute of Environmental and Scientific Research

(a) See paragraph 16.15.

18.25 Environmental Laboratory Services

(a) See paragraph 16.16.

- **the extent to which existing competitors, near competitors and importers could expand in the market, and any difficulties that they might face in doing so**

18.26 In respect of the tender markets for the meat, dairy and milk industries, all competition comes from near entrants because the current PT provider is the only 'active' participant in the New Zealand market. However, the near entrants are all capable of entering/expanding and competing successfully. Sufficient mass is needed to compete and this will be derived from having a powerful customer such as the NZFSA, Fonterra or the Raw Milk Laboratories Group choosing to obtain their PT services from the entrant.

18.27 With the exception of milk, New Zealand's quarantine restrictions are not sufficiently costly or onerous to be a significant barrier to entry for offshore providers.

***The Tender Market for the Provision of PT services to the Meat Industry***

18.28 Competition for the provision of PT services to the meat industry occurs at the time of a tender round, rather than on a continuing basis. Therefore, althoughASUREQuality contracts directly with the NZFSA for the provision of PT services to the entire industry, New Zealand Laboratory Services, IFM Quality Services or FAPAS could expand into the market. This is further supported by the fact that IFM Quality Services, among others, has been invited to tender for the NZFSA PT contract later in the year.

***The Tender Market for the Provision of PT services to the Dairy Industry***

18.29 Competition in the dairy industry occurs at the time of a tender round. Should Fonterra become dissatisfied with the pricing or quality of its dairy PT services, it can encourage other PT providers to tender, or it may choose to conduct PT programmes in-house.

(a) New Zealand Laboratory Services, IFM Quality Services, FAPAS or LGC Standards have many of the necessary specialist skills necessary to develop and provide dairy



chemistry and microbiology PT programmes. If Fonterra was dissatisfied with PT services from the merged entity, it would most likely work with other industry stakeholders to encourage a new entrant to enter the market and tender (as the Dairy Board and dairy companies did in 1999). Fonterra has control of the mass necessary to make a new entrant viable.

- (b) Fonterra has, or can have, access to all the necessary technical and physical resources to set up and run in-house dairy PT programmes. Fonterra operates its in-house PT programme where it is unable to find a suitable service/price package in the market, or where it is cost-effective to do so.
- (c) In the event Fonterra increases its use of in-house PT resources, there would be insufficient mass for testing in the industry PT programme. Other dairy laboratories would be forced to follow Fonterra's example by making more use of in-house PT systems or might contract with Fonterra for supply in order to achieve consistent outcomes.

### ***The Tender Market for the Provision of PT services to the Milk Industry***

- 18.30 As discussed in paragraphs 16.3, 16.7, and 16.11, New Zealand Laboratory Services and SAITL have many of the specialist skills necessary to develop and provide milk chemistry and microbiology PT programmes, illustrating the competence and scale of existing capability within the industry.

### ***The Market for the Provision of General PT services***

- 18.31 As stated above at paragraphs 16.10 and 16.13, international firms are always an option for customers requiring general PT services. LGC Standards and WEPAL could concentrate on expanding in the New Zealand market, or they could establish a programme based entirely on New Zealand customers' samples for any of the PT programmes operating in New Zealand.
- 18.32 Additionally, ESR and ELS have the potential to expand in the market. See paragraphs 16.15 and 16.16 for further discussion.

## **POTENTIAL COMPETITION**

### **CONDITIONS OF ENTRY**

19. **Please explain the requirements for new entry and/or importers in the relevant market(s), including:**

- **a breakdown of the estimated costs;**

**Estimated Costs might include, for example, raw materials, machinery, specialised assets, sunk Costs and/or any other costs which may be necessary for new entry.**

- **anticipated timeframes;**
- **regulatory requirements;**
- **frontier requirements (e.g., tariffs, import licensing, quarantine requirements); and**
- **business requirements involved.**

- 19.1 Broadly, a new entrant needs to secure a contract from a dominant customer or a laboratory grouping of sufficient size to be viable – from both a technical (statistical) and financial viewpoint. A term of three years or more would probably be required, and there would need to be a reasonable prospect of contract renewal or ongoing business. Such an entrant would likely be an existing supplier of PT services operating in an overseas locality, but providing services into New Zealand, or a laboratory wishing to diversify and already having close industry connections.
- 19.2 The following costs of entry, as distinct from barriers, are relevant for a new entrant in meat, dairy or milk:
- (a) an estimated \$150,000 to \$200,000 and six months for set up; and
  - (b) suitable expertise, which is readily available or, in the alternative, readily trained in approximately twelve months.
    - (i) For many sample types, preparation of samples requires a skill set equivalent to that of a laboratory analyst experienced with the particular product. These skills can be readily recruited or, alternatively, are available through service contracts from testing laboratories.
    - (ii) Some products require special techniques for stable preparation and/or storage. Equivalent systems could be developed by a new entrant, or experienced personnel could be recruited (as in the case of PSL entry, from the incumbent).
    - (iii) Preparation of microbiological samples require specialist skills, however experienced microbiologists are familiar with maintenance of reference cultures for use as positive controls. Much of the skill set is equivalent between these two activities, so an experienced microbiologist would be a good start.
    - (iv) Evaluation of PT results requires a basic statistical knowledge and an understanding of the test methods being used. Competent analysts or quality assurance personnel will often have the requisite skills to be quickly trained for this function.
    - (v) Specialist software is required to process the volume of data, but a new entrant could develop necessary software from international standards, peer-reviewed journals etc., or directly from customer specifications.
- 19.3 None of these could be considered to be a significant barrier to entry.
- 19.4 Other programmes such as water chemistry, soil, fats and oils, beverages etc., are not large enough to support a new entrant within New Zealand, so it is unlikely a new competitor for these programmes would emerge from within New Zealand.
- 19.5 For these markets a more likely scenario, and a greater competitive threat, would involve international providers either promoting their PT services to New Zealand customers, i.e., via their websites, conferences etc., or being encouraged by New Zealand customers to supply the market directly. Such entities may have a range of products of higher quality than is possible with the limited pool of participants from New Zealand and may offer competitive pricing. The Applicants estimate that the set-up costs in this regard would be less than \$100,000.

20. **Include a full discussion on:**

- **any factors that could impede entry; and**
- **what might prompt new entry post-merger.**

- 20.1 In a situation where laboratories were unhappy with the price or quality of PT services, major customers such as the NZFSA, Fonterra and the Raw Milk Laboratories Group would encourage a new entrant, but the likely outcome would be competition for the market, i.e., the PT services provider would be asked to present a proposal and awarded the entire market.
- 20.2 The ability to secure a contract for an entire PT programme negates any natural barrier to entry to that market. Likewise regulatory barriers are not considered to be substantial in terms of cost or time required to gain the necessary accreditation.
- 20.3 Although suitable expertise is required, such as that discussed in paragraph 19.2, it is readily available or, in the alternative, readily trained in approximately 12 months.
- 20.4 This indicates that the Applicants are constrained (and will continue to be constrained) by the prospect of an actual or potential bidder, who, with encouragement from the relevant industry, would enter that market if the Applicants were to attempt to reduce the quality of services or to price at non-competitive levels.

LIKELIHOOD, EXTENT AND TIMELINESS OF ENTRY (THE LET TEST)

21. **Please name any likely businesses (including overseas businesses) you are aware of that do not currently supply the market but which you consider could supply each of the relevant market(s). Discuss the likelihood of such entry.**

***Entry into the Tender Market for the Provision of PT services to the Meat Industry***

- 21.1 New Zealand Laboratory Services, IFM Quality Services or FAPAS could compete and secure an industry contract, making them a strong competitive threat in the market.
- 21.2 New Zealand Laboratory Services has many of the specialist skills necessary to develop and provide meat chemistry and microbiology PT programmes, as well as established relationships with clients in the meat industry and the relevant regulatory authorities. See paragraph 16.3 for further information.
- 21.3 IFM Quality Services provides a number of PT programmes in food microbiology that meet most of the requirements for the meat industry. See paragraph 16.4 for further information.
- 21.4 FAPAS offers products that could substitute for the meat PT programmes offered by AsureQuality. See paragraph 16.5 for further information.

***Entry into the Tender Market for the Provision of PT services to the Dairy Industry***

- 21.5 In the dairy industry, New Zealand Laboratory Services has many of the necessary specialist skills required to develop and provide milk and dairy chemistry and microbiology PT programmes, and could be encouraged to enter the industry. See paragraphs 16.3 and 16.7 for further information.
- 21.6 IFM Quality Services provides a number of PT programmes in food microbiology that meet most of the requirements for the dairy industry. See paragraph 16.4 for further information.

- 21.7 FAPAS offers products that could substitute for the dairy PT programmes offered by PSL. See paragraph 16.5 for further information.
- 21.8 The expertise and capability of New Zealand Laboratory Services, IFM Quality Services and FAPAS illustrates the likelihood of entry, with the possible extent of entry, as a result of the structure of the tender market, being an outcome of 100 percent market share. Furthermore, entry could occur well within the Commission's general guideline of two years.

***Entry into the Tender Market for the Provision of PT services to the Milk Industry***

- 21.9 SAITL has the experienced staff, market recognition and physical resources required to provide milk chemistry and microbiology PT programmes. See paragraph 16.11 for further information.
- 21.10 New Zealand Laboratory Services also has many of the necessary specialist skills needed to develop and provide milk and dairy chemistry and microbiology PT programmes. See paragraphs 16.3 and 16.7 for further information.

***Entry into the Market for the Provision of General PT services***

- 21.11 For an existing international provider, such as WEPAL or LGC Standards, wishing to supply PT services into the New Zealand market, the capabilities required to provide PT services would already exist. When compared to a domestic entrant, capital costs would be lower but the costs of sample distribution would be slightly higher (given the practice is to provide or courier samples to participants). A lesser commitment from a smaller group of laboratories would be required, thus increasing the likelihood of entry.
- 21.12 In New Zealand, both ESR and ELS have the ability to respond to an attempt by a PT provider to price or contract on an anticompetitive basis in the general PT services market. Moreover, ESR has been involved in PT tender processes before and has identified an interest in entering the market.

**22. To what extent do you consider that potential entry would be sufficient to constrain the merged entity in the markets affected?**

- 22.1 The PT services market is characterised by low barriers to entry and, in respect of the meat, dairy and milk industries, a number of near entrants who can be encouraged and supported to enter by customer groups in the event of an attempt to engage in anticompetitive behaviour. Furthermore, in most cases, the support of customers would guarantee new entrants 100 percent market share and long term contracts.
- 22.2 The expertise and capabilities of near entrants illustrates the high likelihood of entry, with the extent of the entry, given the nature of industry-wide contracts, bringing an outcome of up to 100 percent market share. Furthermore, the timeliness of entry would be within the Commission's general guideline of two years.
- 22.3 There are also existing overseas competitors who have the ability to engage in the New Zealand market.
- 22.4 Therefore, the Applicant believes that the threat of market entry and the related impact of loss of 'the market' would act as a sufficient constraint on the merged entity post-Acquisition, should it attempt to reduce the quality of services or to price at non-competitive levels.
- 22.5 In 1999, PSL recruited skilled personnel, acquired the necessary equipment and contracted provision of specialist laboratory services to support the launch of a new programme in dairy and milk chemistry and microbiology. This was achieved within three months from registration of the company. This example illustrates that barriers to entry are not a

significant constraint when weighed against the resources and countervailing power of buyers, and the capability of offshore providers and potential near entrants.

**23. How long would you expect it to take for entry to occur, and for market supply to increase, in respect of each of the potential entrants named in question 21 above? Provide reasons for your estimates.**

23.1 As detailed in paragraph 19.2, given that potential entrants are generally able to secure contracts for entire PT programmes with minimal capital, facilities and personnel, successful entry could occur within six to twelve months.

## **COUNTERVAILING POWER OF BUYERS**

**24. To what extent do you consider that the merged entity would be constrained in its actions by the conduct of buyers in the markets affected? Where relevant, please include:**

- **a full discussion on the ability of buyers to self supply or import, and the alternative sources of supply available to buyers; and**
- **evidence of buyers seeking alternative supply and/or switching suppliers.**

24.1 In the three tender markets, countervailing power lies with three bodies that respectively have control of the mass of laboratory testing in respect of the meat, dairy and milk industries; the NZFSA, Fonterra and the Raw Milk Laboratories Group.

24.2 Buyers such as the NZFSA, Fonterra and the Raw Milk Laboratories Group have the ability to constrain PT providers through their size, the availability of alternative sources of supply, the ability to collectively, with the remainder of their respective industry laboratories, switch providers and the ability to foster new supply by supporting a new entrant with a long term contract. Whether or not there is to be a re-tender or renewal by agreement is in the hands of these buyers.

24.3 The threat of a re-tender, or alternatively, the threat that the NZFSA, Fonterra or the Raw Milk Laboratories Group will encourage another PT provider to tender (by way of guaranteed terms etc.) will largely constrain the merged entity and incentivise it to maintain pro-competitive services and pricing. The fact that the NZFSA and Fonterra have both indicated that they support the Acquisition is evidence of a lack of concern, which derives from their countervailing power. This countervailing power exists today and there is little difference between the counterfactual and the factual.

24.4 In respect of general PT services, buyers have enough alternative PT providers, such that the mere threat of switching is sufficient to constrain the merged entity.

24.5 As stated at paragraph 8.7, AsureQuality provides laboratory services to various industries, in addition to the PT services it offers. AsureQuality's food laboratory services business is approximately [●] times the size of its PT services business calculated on a revenue basis. Consequently, where PT services buyers also purchase laboratory services from AsureQuality, they will have the ability to penalise AsureQuality, and therefore NewCo, in larger, more lucrative markets.<sup>31</sup>

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<sup>31</sup> PT customers who are also laboratory customers of AsureQuality, are listed in Appendix 4.

24.6 AsureQuality will still have 60 percent ownership of NewCo and therefore control - NewCo will inevitably be treated by customers as part of the same group as AsureQuality for the purpose of threatening to penalise any anticompetitive actions on the part of NewCo.

25. **If you consider that there is a constraint from buyers, identify the top five buyers by sales and/or volume (including overseas companies/importers) in the relevant market(s), Where there are significant differences in the size of the buyers please provide details for five medium and five small buyers.**

See Appendix 4 for details.

**COORDINATED MARKET POWER**

26. **Identify and discuss the various characteristics of the market that, post-merger, you consider would either facilitate or impede coordination.**

26.1 Whether an acquisition will increase the scope for the exercise of coordinated market power depends on the degree of market share concentration, the product in question and the nature of the competitive process in the relevant markets. In considering the scope for coordinated conduct, it is necessary to assess whether the markets currently show signs of coordinated market power, and to assess whether the Acquisition affects any of those factors currently precluding, or facilitating, the exercise of coordinated market power.

26.2 The meat, dairy and milk PT services markets do not currently display signs of coordinated market power due to the markets being governed by tender and the tendency to rollover contracts at expiry of the term which avoids transparency.

26.3 In the instances where coordinated market power could arise, i.e., at the time of a tender round, the main factors precluding the exercise of coordinated market power are:

- (a) large customers able to detect and punish any attempt to tacitly collude; and
- (b) the absence of price transparency – actual prices are the result of a bid process.

26.4 As the table below indicates, none of the factors currently precluding coordinated conduct will change as a result of the Acquisition therefore the Acquisition cannot be said to facilitate tacit collusion.

| Scope for coordinated market power | Present | Effect of Acquisition  |
|------------------------------------|---------|------------------------|
| High seller concentration          | Yes     | Increase <sup>32</sup> |
| Undifferentiated product           | Yes     | No change              |
| Static production technology       | Yes     | Increase               |
| New entry slow                     | No      | No change              |
| Absence of fringe competitors      | No      | No change              |

<sup>32</sup> In respect of the three tender markets, there is no seller competition – all other potential suppliers are near entrants and that remains true in both the factual and the counterfactual.

| <b>Scope for coordinated market power</b>                    | <b>Present</b> | <b>Effect of Acquisition</b> |
|--|----------------|------------------------------|
| Acquisition of an unusually vigorous or effective competitor | No             | No change                    |
| Price inelastic market demand                                | No             | No change                    |
| History of coordinated conduct                               | No             | No change                    |
| Absence of countervailing power of acquirers                 | No             | No change                    |
| Existence of excess capacity                                 | No             | No change                    |
| Industry associations/fora                                   | Yes            | No change                    |
| <b>Detection of deviation from coordination</b>              | <b>Present</b> | <b>Effect of Acquisition</b> |
| High Seller concentration                                    | Yes            | Increase <sup>33</sup>       |
| Frequent sales   | No             | No change                    |
| Vertical integration   | No             | No change                    |
| Growth in demand   | No             | No change                    |
| Cost similarities  | Yes            | No change                    |
| Multi market contact   | No             | No change                    |
| Price transparency   | No             | No change                    |

## EFFICIENCIES

27. **If applicable, provide a description of any efficiencies that you believe the acquisition could bring. Would such efficiencies enhance rivalry, or offset the impact of a lessening of competition? Please include a full discussion on:**

- **how the merger would facilitate the realisation of efficiency improvements. Specify the steps the combined entity anticipates it would take, and the timeframe needed, to achieve the efficiencies. Where relevant, include a discussion of the risks and costs involved;**

27.1 Generally, there would be the removal of duplication in head office expenses and business systems e.g., payroll, human resources, financial reporting etc. For information technology systems there would be elimination of duplication in software development, system maintenance, administration and management.

27.2 Efficiencies would also occur in the production, testing and distribution of dairy and milk chemistry and microbiology samples (duplicate systems currently supply New Zealand and Australia respectively):

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<sup>33</sup> Above n34.

- (a) in microbiology generally – there would be elimination of duplicated capabilities and economies of scale from increased production volumes; and
- (b) rationalisation of international despatch systems - at present there is duplication of despatches to the same destinations.

27.3 The Applicants anticipate that reviews would be undertaken in each area of the merged entity to identify how best to rationalise and integrate existing systems. It is expected that it would take 12 to 24 months to realise most of these gains. With the exception of information technology, costs of integration are expected to be less than annual savings. To estimate information technology savings would itself require significant investment.

- **the magnitude of the efficiencies, whether the impact would be on fixed, variable or other costs, and generally how the cost structure of the merged entity would change;**

27.4 The Applicants do not know the magnitude of efficiencies, but the best estimate at this stage is five to ten percent of operating costs. Both fixed and variable costs would be affected; in aggregate, it is likely more fixed than variable costs would be affected.

- **whether such efficiencies could be realised without the merger, or over a longer timeframe; and**

27.5 Some of the efficiencies could be realised by collaboration between the Applicants, but this will not happen without some form of agreement protecting intellectual property and confidential information which would effectively limit competition. The Applicants wish to enlist support of the relevant industries and the government instead.

- **whether, and the extent to which, such efficiencies would be passed on to the customers of the merged entity.**

27.6 This would be decided by the Board of Directors of the merged entity. Efficiencies would be passed on through prices or product/service quality.

## **OTHER FACTORS**

28. **Where relevant, provide a description of any other features of the market(s) that should be taken into account in considering the effect of the proposed merger.**



## **Part 6: Further Information and Supporting Documentation**

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29. **Provide the contact details of relevant competitors, buyers and suppliers and any other relevant market participants in the form of the example table shown below.**

Please refer to Appendix 2.

30. **Please provide a copy of the most recent annual report for each of the merger parties. If an annual report is not available, please provide a copy of the audited financial statements of the merger parties (profit and loss account, showing total turnover and profit before tax, and balance sheet). If the merger only relates to a segment of the business of the merger parties, please also provide a copy of any management accounts for the relevant business segment.**

Please refer to Appendix 3.

## Part 7: Confidentiality

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31. **If you wish to request confidentiality for specific information contained in or attached to the notice, please state why you consider the information to be confidential and state the reasons for your request in terms of the criteria set out in the Official Information Act 1982.**
- 31.1 Confidentiality is sought in respect of the information in this application that is contained in square brackets. Confidentiality is sought for the purposes of section 9(2)(b) of the Official Information Act 1982 on the grounds that:
- (a) the information is commercially sensitive and contains valuable information which is confidential to the Applicants; and
  - (b) disclosure would be likely unreasonably to prejudice the commercial position of the Applicants, as the parties providing the information.
- 31.2 The Applicants also request that they are notified of any request made to the Commission under the Official Information Act 1982 for the confidential information, and that the Commission seeks the Applicants' views as to whether the information remains confidential and commercially sensitive at the time those requests are being considered.
- 31.3 The foregoing applies equally in respect of any additional information provided to the Commission that is expressed to be confidential.
32. **Provide a separate schedule of all confidential information claimed in the application.**
33. **Provide two copies of the application. One copy must be a confidential version and the other a public version.**
- 33.1 **In the confidential version of the application any information for which confidentiality is sought must be highlighted in bold and contained in [square brackets].**
- 33.2 **In the public version the confidential information should be removed from within the square brackets, with the brackets remaining, thus [●].**

A hard copy, and an electronic copy of the confidential version and the public version both in Microsoft Word format and in PDF format, should be sent to the email address: registrar@comcom.govt.nz.

THIS NOTICE is given by **AsureQuality Limited**.

**AsureQuality Limited** hereby confirms that:

- all information specified by the Commission has been supplied;
- if information has not been supplied by **AsureQuality Limited**, reasons have been included as to why the information has not been supplied;
- all information known to **AsureQuality Limited** which is relevant to the consideration of this application notice has been supplied; and
- all information supplied by **AsureQuality Limited** is correct as at the date of this application/notice.

**AsureQuality Limited** undertakes to advise the Commission immediately of any material change in circumstances, relative to its information and knowledge, relating to the application/notice.

Dated this                      day of October 2010.

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Signed by **Udit Singh**

Group Manager - Laboratories & Diagnostics  
**AsureQuality Limited**

I am duly authorised to make this application/notice.

THIS NOTICE is given by **Proficiency Services Limited**.

**Proficiency Services Limited** hereby confirms that:

- all information specified by the Commission has been supplied;
- if information has not been supplied by **Proficiency Services Limited**, reasons have been included as to why the information has not been supplied;
- all information known to **Proficiency Services Limited** which is relevant to the consideration of this application notice has been supplied; and
- all information supplied by **Proficiency Services Limited** is correct as at the date of this application/notice.

**Proficiency Services Limited** undertakes to advise the Commission immediately of any material change in circumstances, relative to its information and knowledge, relating to the application/notice.

Dated this                      day of October 2010.

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Signed by **Christopher Ingram**

Director  
**Proficiency Services Limited**

I am duly authorised to make this application/notice.

## **APPENDIX 1 – Heads of Agreement (Confidential to the Applicants)**

The Heads of Agreement between AsureQuality and PSL is **attached** as a separate PDF file. The document is confidential.

**APPENDIX 2 – Contact Details  
(Confidential both to and between the Applicants)**

|                                    | NAME OF COMPANY  | CONTACT DETAILS  | RELEVANT CONTACT PERSON  |
|------------------------------------|--|--|--|
| COMPETITORS<br>(near and existing) | New Zealand Laboratory Services Limited (NZ Labs)                    | 35 O'Rorke Road<br>Penrose<br>Auckland<br>+64 9 579 2669<br>auckland@nzlabs.co.nz                                      | Brian Watson<br>General Manager                                      |
|                                    | IFM Quality Services Pty Limited (IFM Quality Services)              | 4/58 Stennett Road Ingleburn<br>NSW 2565 Australia<br>+61 2 9618 3311<br>ContactIFM@ifmqs.com.au                       |  |
|                                    | FAPAS  | Sand Hutton, York<br>United Kingdom<br>YO41 1LZ<br>+44 1904 462100<br>info@fapas.com                                   |  |
|                                    | Fonterra Co-operative Group (Fonterra)                               | www.fonterra.co.nz<br>+ 64 7 839 8361  | Stan Bunting<br>Quality & Compliance Manager                         |
|                                    | LGC Standards  | Europa Business Park<br>Barcroft Street, Bury<br>Lancashire, BL9 5BT<br>+44 161 762 2500<br>customerservices@lgcpt.com |  |
|                                    | South Auckland Independent Testing Society Limited (SAITL)           | State Highway 1, Te Rapa<br>Hamilton<br>+64 7 849 8671<br>www.saitl.co.nz  | Margaret Malloch<br>General Manager                                  |
|                                    | Wageningen Evaluating Programmes for Analytical Laboratories (WEPAL) | Bornsesteeg 10<br>6721 NG Bennekom<br>The Netherlands<br>+31 317 482337/482349<br>Info.Wepal@wur.nl                    |  |
|                                    | The Institute of Environmental and Scientific Research (ESR)         | 34 Kenepuru Drive<br>Porirua, Wellington<br>+64 4 914 0700<br>enquiries@esr.cri.nz                                     | David Talbot<br>General Manager,<br>Business Development & Marketing |
|                                    | Environmental Laboratory Services (ELS)                              | 85 Port Road, Seaview<br>Lower Hutt<br>+64 4 568 1203<br>solutions@els.co.nz   | Rob Deacon<br>General Manager  |
| PT BUYERS                          | [●]  | [●]  | [●]  |
|                                    | [●]  | [●]  | [●]  |

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|---------------------------|--|--|--|
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### **APPENDIX 3 – Financial Statements of the Applicants (Confidential both to and between the Applicants)**

AsureQuality's Annual Report and PSL's financial statements are **attached** as separate PDF files.

Due to the fact that PSL is a private company, its financial statements are confidential.

## **APPENDIX 4 – Applicants’ Customers (Confidential both to and between the Applicants)**

### PT Services

#### **1. Laboratory customers of AsureQuality**

##### ***The Tender Market for the Provision of PT services to the Meat Industry***

#### **1.1 [●]**

##### ***The Market for the Provision of General PT services<sup>34</sup>***

#### **1.2 [●]**

#### **2. Laboratory customers of PSL**

##### ***The Tender Market for the Provision of PT services to the Dairy Industry***

#### **2.1 [●]**

##### ***The Tender Market for the Provision of PT services to the Milk Industry***

#### **2.2 [●]**

##### ***The Market for the Provision of General PT services***

#### **2.3 [●]**

### Laboratory Testing Services

#### **3. Customers of AsureQuality (who are also PT customers)**

#### **3.1 [●]**

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<sup>34</sup> Each is a small customer in themselves, with external laboratories comprising the largest grouping and still less than 20 percent of the overall general PT programme revenues.