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Statement of Preliminary Issues

Life Health Foods / Chalmers Organics

8 February 2022

Introduction

1. On 23 December 2021 the Commerce Commission registered an application (the Application) from Life Health Foods NZ Limited (Life Health Foods) seeking clearance to acquire 100 percent of the assets of Chalmers Organics Limited (Chalmers) (the Proposed Acquisition).[1]

2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **22 February 2022.**

5. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

6. Life Health Foods and Chalmers both supply a range of vegetarian and plant-based products to supermarkets and other retail stores, as well as to the food service industry[3] and home delivery[4]. Their meat alternative products include tofu, plant-based burger patties, and plant-based sausages.

7. Life Health Foods is owned by the New Zealand Conference Association, a registered charitable trust that also owns the Sanitarium Health Food Company (Sanitarium). Life Health Foods manufactures and supplies vegetarian and plant-based products in New Zealand, under brand names including Bean Supreme, Alternative Meat Co.,

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

[2] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

[3] This comprises sales to restaurants, cafes, and similar, often through intermediaries.

[4] These sales are usually made as a part of meal kits.

Vegie Delights and Lisa's. Sanitarium also manufactures plant-based dairy alternative products, including dairy-free milk and frozen desserts under the So Good brand.

8. Chalmers is based in Auckland and manufactures a range of plant-based meat alternative products under the Tonzu and Zenzo brands. It also manufactures a range of plant-based dairy alternative products, including cheese alternatives, yoghurt alternatives and sour cream alternatives under its Zenzo brand.

Our framework

9. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[5] As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

10. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[6] This allows us to assess the degree by which the Proposed Acquisition might lessen competition.

11. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:

    11.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;[7]

    11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    11.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Market definition

12. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately

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5 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz.

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

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

determined, in the words of the Commerce Act 1986, as a matter of fact and commercial common sense.[8]

13. Life Health Foods and Chalmers both manufacture plant-based meat alternative products. In the Application, Life Health Foods submitted that the relevant market is a national market for the wholesale supply of meat alternative products. Life Health Foods submitted that:[9]

13.1 the same equipment can be used to manufacture a range of different meat alternative products;

13.2 there are no significant barriers to a manufacturer of other vegetable-based products switching to manufacturing alternative burger patties, alternative sausages, and tofu;

13.3 all the major suppliers of meat alternatives distribute their products nationally; and

13.4 both large and small retailer customers have the same requirements in terms of packaging and supply, and meat alternative suppliers could readily supply all customers.

14. We will consider whether these are the appropriate markets for assessing the competition effects of the Proposed Acquisition, including whether:

14.1 end consumers consider the different types of meat alternative product to be substitutes for one another (eg, are meat alternative patties substitutes for meat alternative sausages, tofu etc?);

14.2 end consumers consider meat alternative products to be substitutes for meat products or other protein products (eg, are meat alternative patties substitutes for meat patties?);

14.3 manufacturers of meat alternative products can easily switch production between the different types of meat alternative products; and

14.4 any customers have special characteristics that means their alternatives are different to other customers (eg, do customers in the food service industry have different requirements for meat alternative products than grocery retailers?).

Without the acquisition

15. We will consider what the merging parties would do if the Proposed Acquisition does not proceed. We will consider the evidence on whether the without-the-acquisition

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

9 The Application at [5.30].

scenario is best characterised by the status quo or whether there are other likely counterfactual scenarios.

16. As part of this, we will consider whether, absent the Proposed Acquisition, either or both of the merging parties would be likely to launch any new products.

Preliminary issues

17. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral, coordinated or conglomerate effects might result from the Proposed Acquisition.

18. The questions that we will be focusing on are:

    18.1 unilateral effects: would the loss of competition between the Parties enable the merged entity to profitably raise prices by itself?

    18.2 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

    18.3 conglomerate effects: would the Proposed Acquisition give the merged entity the ability and incentive to foreclose rivals?

Unilateral effects

19. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.

20. In markets where products differ slightly from one another (known as 'differentiated markets'), some products will be closer substitutes and compete more vigorously with each other than others. Unilateral effects are therefore more likely to arise where the products produced by the merger parties are relatively similar.

21. In the Application, Life Health Foods submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any relevant market(s) due to unilateral effects because:[10]

    21.1 Life Health Foods and Chalmers have largely complementary meat alternative product portfolios, overlapping in just three meat alternative categories: burger patties, sausages and tofu[11];

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10 The Application at [6.1 (a)-(d)].
11 The Application at [4.18]-[4.20]

21.2 the merged entity would to face vigorous competition from existing meat alternative suppliers;

21.3 the demand for meat alternatives is growing and existing suppliers are expanding because the barriers to entry and expansion are low[12];

21.4 meat alternatives can be easily imported meaning that the merged entity would be constrained by suppliers based overseas, as well as those based in New Zealand[13]; and

21.5 the major supermarket retailers would have countervailing power through an ability to expand their range of private label products, reducing shelf space allocated to meat alternative suppliers and/or sponsor the expansion of an existing competitor.[14]

22. We will consider:

22.1 closeness of competition: the degree of constraint that LHF and Chalmers impose upon one another, and that would be lost with the Proposed Acquisition;

22.2 remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity;

22.3 entry and expansion: how easily rivals could enter and/or expand in response to an increase in price by the merged entity; and

22.4 countervailing power: whether customers have special characteristics that would enable them to resist a price increase by the merged entity.

Coordinated effects

23. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase.

24. Life Health Foods submits that the Proposed Acquisition will not give rise to coordinated effects because:[15]

24.1 the Proposed Transaction will not result in the removal of a particularly vigorous or destabilising competitor;

24.2 there is a high degree of product differentiation, particularly in relation to burger patties and sausages;

[12] The Application at [6.31] and [6.32]
[13] The Application at [6.36]
[14] The Application at [6.42]
[15] The Application at [6.46(a)-(d)].

24.3 there are a number of competitors in the market and wholesale pricing is not transparent, as these are negotiated confidentially with retail customers; and

24.4 the significant countervailing power of supermarkets would inhibit any attempt to coordinate on prices.

25. We will consider whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Conglomerate effects

26. A conglomerate merger is a merger between firms that supply products that may relate to each other (for example, complementary products). Conglomerate effects occur when a merged firm gains the ability and incentive to foreclose competitors by using anticompetitive strategies that leverage its position in some of its products (particularly 'must-have' products), such as anticompetitive tying or bundling strategies.

27. We will assess whether the Proposed Acquisition would give the merged entity the ability and incentive to bundle or tie its products anticompetitively.

Next steps in our investigation

28. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed acquisition by 11 March 2022**.** However, this date may change as our investigation progresses.[16] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

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

Making a submission

30. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Life Health Foods/Chalmers" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **22 February 2022**.

31. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

32. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the

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

OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.