



COMMERCE COMMISSION

Statement of Preliminary Issues

Sanford / Pacifica Seafoods

14 October 2010

11.4/12455

INTRODUCTION

1. On 29 September 2010, the Commerce Commission received an application from Sanford Limited seeking clearance to acquire the Pacifica Seafoods Group of companies. The public version of the application can be accessed on the Commission's website at:

<http://www.comcom.govt.nz/assets/Uploads/PUBLIC-Application-Sanford-Ltd-Pacifica-Seafoods-Group-Final2.pdf>

2. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as the Commission's assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.
3. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger.

RELEVANT PARTIES

The Acquirer – Sanford Limited

4. Sanford Limited is a publicly listed fisheries company based in Auckland. Its largest shareholder is Amalgamated Dairies, the investment vehicle of the Goodfellow family. Sanford is active in the aquaculture industry particularly the farming, processing and selling of mussels, king salmon and oysters.

The Target – Pacifica Seafoods Group

5. The Pacifica Seafoods Group of five companies are owned by the Skeggs Group Limited. Skeggs Group is owned by a small number of individuals. Pacifica Seafoods primarily supplies mussels although it also has some king salmon and oyster operations.

ANALYTICAL FRAMEWORK

6. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. The first step of the Commission's

analytical framework¹ is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the proposed acquisition. The Commission then considers the relevant products and geographic regions that constitute close substitutes from both a customer's and a supplier's point of view.

7. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:
- with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).

The impact of the acquisition on competition is then viewed as the prospective difference between those two scenarios.

8. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:
- existing competition - the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices;
 - potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so;
 - the countervailing market power of buyers - the potential for a business to be sufficiently constrained by purchasers' ability to exert an influence on price, quality and/or terms of supply; and
 - coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.
9. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition may lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

PRELIMINARY ISSUES

10. Of the factors outlined in the previous section, the Commission currently considers its focus in respect of the proposed acquisition will be on the following areas:

Areas of Overlap – Market Definition

11. At present, both Sanford and Pacifica farm, process and wholesale mussels. While the majority of these mussels appear to be exported, both Sanford and Pacifica supply their mussels in New Zealand and this New Zealand supply is the focus of the Commission's investigation.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

12. Sanford also farms, processes and wholesales King Salmon and Pacific Oysters. Pacifica also supplies some King Salmon and some Pacific Oysters although they appear smaller than its mussel operations. Nevertheless, the Commission will also investigate whether the issues outlined below in respect to mussels are also relevant in respect to salmon and to oysters.
13. In assessing the relevant market in respect of mussels, the Commission will consider the following areas:
- whether there is a difference between the supply of fresh mussels compared to frozen mussels (or any other processed variant) in New Zealand;
 - what is the most relevant functional level that the Commission should focus on. Both Sanford and Pacifica are vertically integrated in that they farm, process and market mussels while there appear to be other suppliers in the industry who only operate at one functional level;
 - while mussels are sold throughout New Zealand, the Commission will assess to what extent unprocessed and processed mussels able to be transported significant distances and, if not, whether the relevant geographic market is regional in scope; and
 - the Commission will investigate whether the demand of the main customers such as those in the grocery channel and those in the restaurant/food service channel are significantly different, which could put them in discrete customer markets.

Existing Competition

14. Sanford has advised that for some products the proposed acquisition would fall outside the Commission's safe harbour thresholds.² However, Sanford has submitted that, post acquisition, there will be a number of competitors supplying for mussels, salmon and oyster at all the various stages of the supply chain that will be able to expand their operations to compete in the event that the merged entity raised its prices. The Commission will test the accuracy of this submission.
15. The Commission will investigate who are the main competitors to Sanford and Pacifica and the nature of this competition. In particular, the Commission will investigate which entities mussel farmers compete with and which entities mussel processors compete with.
16. Given the large volume of exports in this industry, the Commission will investigate whether it would be rational for an exporter to divert sales away from the export sector to the domestic market, should the merged entity attempt to increase its price or reduce its quality.

Potential Competition

17. The Commission is also interested in ascertaining how difficult it is to enter the aquaculture industry. Historically, the barriers to entry in this industry appear to have been relatively high although Sanford has submitted that recent Government initiatives have reduced these barriers. The Commission will consider what is required to establish a successful farming operation and, separately, a successful processing operation.

² Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004, Section 5.3

18. In order to act as a constraint, entry must be likely. The Commission will therefore consider the likelihood of entry in the event that prices are increased, post acquisition.

Countervailing power

19. The Commission will assess whether any of the main shellfish and salmon customers, whether in the grocery or supermarket channel or the food service/restaurant channel, will be able to exercise any countervailing power against the combined entity through the threat of switching or any other mechanism.

Other Competition Factors

20. The Commission will assess whether the reduction in the number of competitors, as a result of the proposed acquisition, will enhance the ability of the remaining market participants to collude either tacitly or explicitly.

NEXT STEPS

21. In line with the Commission's Merger and Acquisitions Clearance Process Guidelines (available on the Commission's website at www.comcom.govt.nz), the Commission has established a draft timeframe for consideration of the issues and Sanford's application for clearance. An extension of time was agreed to by the Applicant such that the Commission should make its final decision by 26 November 2010. However, also in line with the Merger and Acquisitions Clearance Process Guidelines, this timeframe could change. To keep abreast of possible changes in relation to timing and to find relevant documents, visit the Clearance Public Register on the Commission's website at:

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

22. As part of its investigation, the Commission will identify the parties it believes will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks.
23. The Commission also invites submissions from any other parties who consider they have information relevant to the Commission's consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference Sanford / Pacifica in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by **5pm on Friday 22 October 2010**. Please clearly identify any confidential information contained in the submission and provide contact details.