

Statement of Preliminary Issues

T&G/Freshmax

21 February 2020

Introduction

1. On 11 February 2020, the Commerce Commission (the Commission) registered an application (the Application) from Turners & Growers Fresh Limited (T&G) seeking clearance to acquire 100% of the shares in Freshmax NZ Limited (Freshmax) (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 **6 March 2020**.

The parties

5. T&G grows, imports and wholesales fresh produce in New Zealand and exports locally grown fresh produce. T&G also operates a produce distribution network and undertakes contract ripening for customers. T&G is a wholly owned subsidiary of T&G Global Limited.
6. Freshmax imports and wholesales fresh produce in New Zealand. Freshmax provides distribution, fumigation, packing, ripening, quality control and cool-store services. Freshmax is a wholly owned subsidiary of Freshmax NZ Group Limited.
7. The parties overlap in the wholesale supply of fresh produce to retailers and other parties in New Zealand.

Our framework

8. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.³ As

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.

required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

9. 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).⁴ This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
10. 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:
 - 10.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
 - 10.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 10.3 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

11. 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 determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.⁵
12. In the Application, T&G submitted that the relevant markets for assessing the Proposed Acquisition are the markets for:⁶
 - 12.1 the wholesale supply of fresh produce in New Zealand;
 - 12.2 the supply of cool-chain distribution services in New Zealand, which involves the provision of specialised refrigerated equipment for the distribution of chilled foods across New Zealand; and
 - 12.3 the supply of contract ripening services in the South Island, which involves the ripening of different types of produce for customers.

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz

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

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

⁶ The Application at [7.1].

Markets for the supply of fresh produce

Product dimension

13. T&G submitted that all categories of fresh produce are in the same market because there is a high degree of demand and supply-side substitutability. It submitted that the requirements to wholesale the different types of fresh produce are identical, regardless of the type (or origin) of fruit or vegetable that is being supplied. It also submitted that retailers switch between purchasing different types of produce depending on the price and quality of that produce.⁷
14. We will test whether there should be one broad market for the wholesale supply of fresh produce, or more narrowly defined markets based on produce type or categories of produce.

Customer and functional dimensions

15. T&G submitted that there is a single market for the supply of fresh produce to all retailers, regardless of a retailers' size or the method of supply. It submitted that individual retailers purchase fresh produce in a variety of ways such that the relevant market encompasses multiple supply methods including direct category supply and market trading sales.⁸ T&G also included the supply of produce by growers direct to customers within the scope of the market for the supply of fresh produce.
16. We will test whether the relevant fresh produce market is a single market for the wholesale supply of fresh produce or whether there are distinct customer markets, delineated based on customer size and/or how they purchase fresh produce (ie, direct or through market trading platforms). We will also consider whether the supply of produce by growers direct to customers should fall within the scope of the market for the supply of fresh produce.

Geographic dimension

17. T&G submitted there is a national market for the wholesale supply of fresh produce because wholesalers supply retailers throughout New Zealand. It submitted that the locations of on-site premises (ie, trading floors or distribution centres) throughout the country do not dictate the reach of any wholesaler, given that the cost of freight is not prohibitive.⁹
18. We will test whether the geographic scope of any markets for the supply of fresh produce are national, or narrower markets by island or region.

⁷ The Application at [7.5-7.6].

⁸ The Application at [7.8].

⁹ The Application at [7.3].

Markets for cool-chain distribution and contract ripening services

19. As noted, T&G submitted that the other relevant markets are a national market for the supply of cool-chain distribution services in New Zealand and a South Island market for the supply of contract ripening services.¹⁰
20. We will test whether the geographic scope of any markets for cool-chain distribution and contract ripening services are national, or narrower by island or region.

Without the acquisition

21. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo or whether the counterfactual may be something other than the status quo.

Preliminary issues

22. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant markets by assessing whether horizontal unilateral and/or coordinated effects might result from the Proposed Acquisition.

Horizontal unilateral effects

23. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint such that the merged firm can profitably increase price above the level that would prevail without the merger. The question that we will be focusing on is would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?¹¹
24. In the Application, T&G submitted that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects because:¹²
 - 24.1 in the wholesale supply of fresh produce:
 - 24.1.1 the market share increment caused by the Proposed Acquisition would be insignificant;
 - 24.1.2 T&G would remain constrained by numerous existing competitors, including MG Marketing, Fresh Direct, Seeka Fresh and other wholesalers (including more specialist wholesalers that supply a narrower range of fresh produce);
 - 24.1.3 the merged entity would be constrained by the potential entry or expansion of other wholesalers;

¹⁰ The Application at [7.1].

¹¹ 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.

¹² The Application at 20-41.

- 24.1.4 barriers to entry are low, such that T&G would also be constrained by the threat of new entry;
- 24.1.5 retailers and growers would continue to exercise significant countervailing power on T&G post-acquisition through an ability to bypass any wholesaler and buy and sell fresh produce directly; and
- 24.1.6 the perishable nature of fresh produce means that there is no scope for T&G to artificially increase price or reduce quality;
- 24.2 in the supply of cool-chain distribution services:
 - 24.2.1 there are several other existing competitors, such as MG Marketing and Bidfood who do not face any barriers to expanding their current services;
 - 24.2.2 barriers to entry are low, meaning that T&G would also be constrained by the threat of further new entry; and
 - 24.2.3 customers would continue to exercise significant countervailing power on T&G post-acquisition through an ability to sponsor a new entry or by self-supplying their own cool-chain distribution services;
- 24.3 in the supply of contract ripening services:
 - 24.3.1 T&G and Freshmax only provide ripening services to a limited number of existing customers;
 - 24.3.2 the market share increment caused by the Proposed Acquisition would be insignificant; and
 - 24.3.3 there are several other existing competitors who currently contract ripen fruit for customers in the South Island, who all have excess capacity that would allow them to expand.
- 25. We will consider:
 - 25.1 the closeness of competition: the degree of competitive constraint that T&G and Freshmax impose upon one another. To the extent that any constraint is material, we will assess whether the competition lost between the merging parties could be replaced by rival competitors;
 - 25.2 entry and expansion: the conditions for entry, how easily rivals could enter and/or expand in response to a price increase and/or reduction in the quality of service post-acquisition and whether that is likely in a timely manner; and
 - 25.3 countervailing power: the extent to which customers and growers have special characteristics that would enable them to resist a price increase or reduction in quality or innovation by the merged entity, such as sponsoring new entry or self-supplying.

Coordinated effects

26. 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 prices increase across the market.
27. In the Application, T&G submitted that the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects because:¹³
- 27.1 a large number of competitors would remain, operating a variety of different business models;
 - 27.2 the seasonal nature of fresh produce means that the industry is dynamic and susceptible to demand and supply shocks;
 - 27.3 there has been significant new entry and expansion in the wholesale supply of fresh produce in recent years;
 - 27.4 there is a lack of price transparency in the industry, with prices being privately and bilaterally negotiated between suppliers and customers; and
 - 27.5 there is no evidence that Freshmax represents a material constraint on T&G's prices.
28. We will assess whether the Proposed Acquisition would make coordination more likely, more complete or more sustainable. As part of our assessment 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. In particular, we will assess whether the Proposed Acquisition would make it easier for T&G to monitor and punish the behaviour of rivals and hence make coordination more likely.

Vertical effects

29. A vertical merger is a merger between firms operating at different levels of a supply chain (for example, a wholesaler and a retailer). Vertical mergers can provide merged entities the ability and incentive to foreclose upstream and/or downstream rivals, including by raising the costs of rivals or by changing the conditions of entry to make it harder to enter or expand.
30. In its application, T&G submitted that the Proposed Acquisition would not be likely to substantially lessen competition due to vertical effects because:¹⁴
- 30.1 T&G would not be able to foreclose other growers (customer foreclosure), as:
 - 30.1.1 it would have no incentive to refuse to wholesale produce not grown by T&G, because this would be unprofitable for it to do so; and

¹³ The Application at [9.2].

¹⁴ The Application at [10].

- 30.1.2 other growers would be able to sell their produce through competing wholesalers and/or direct to customers; and
- 30.2 T&G would not be able to foreclose other wholesalers (input foreclosure), none of which are currently dependent on T&G grown produce for their business (T&G grown produce is only wholesaled by T&G).
- 31. To assess whether the Proposed Acquisition might give T&G the ability and incentive to foreclose other growers and importers, we will consider:
 - 31.1 whether T&G would have the ability to foreclose other growers and importers, through having control over an important input;
 - 31.2 whether T&G would have the incentive to foreclose access to customers of competing growers and importers, through earning additional profit from the strategy that outweighs the costs of lost sales; and
 - 31.3 whether the competition lost from any foreclosed competitors would be sufficient to have the likely effect of substantially lessening competition.

Next steps in our investigation

- 32. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **7 April 2020**. However, this date may change as our investigation progresses.¹⁵ In particular, if we need to test and consider further the issues identified above, the decision date is likely to extend.
- 33. 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

- 34. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "T&G/Freshmax" 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 **6 March 2020**.
- 35. 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.
- 36. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

¹⁵ 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.