

COMMERCE COMMISSION

Decision No. 388

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

New Zealand Seafood Investments Limited

and

Basuto Investments Limited

The Commission: M J Belgrave (Chair)
M N Berry
K M Brown
E M Coutts

Summary of Proposed Acquisition: The acquisition by New Zealand Seafood Investments Limited of 100% of the shares in Basuto Investments Limited.

Determination: Pursuant to s 66(3)(a) of the Commerce Act 1986, the majority of the Division of the Commission determines to give clearance for the proposed acquisition.

Date of Determination: 23 March 2000

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CONTAINED IN SQUARE BRACKETS []**

TABLE OF CONTENTS

THE PROPOSAL	4
THE PROCEDURES	4
THE PARTIES.....	4
NEW ZEALAND SEAFOOD INVESTMENTS LTD	4
AMALTAL	5
TALLEY’S	5
AMALGAMATED	5
SANFORD	5
BASUTO	5
SEALORD	6
THE ASSOCIATION BETWEEN THE PARTIES	6
OTHER RELEVANT PARTIES	7
TREATY OF WAITANGI FISHERIES COMMISSION	7
INDEPENDENT FISHERIES LTD (INDEPENDENT)	7
UNITED FISHERIES LTD (UNITED)	8
SIMUNOVICH FISHERIES LTD (SIMUNOVICH).....	8
VELA FISHING LTD (VELA)	8
BACKGROUND	8
SIZE OF THE FISHING INDUSTRY	8
HISTORY PRIOR TO THE QUOTA MANAGEMENT SYSTEM	8
QUOTA MANAGEMENT SYSTEM	9
INDIVIDUAL TRADABLE QUOTAS	9
RECENT HISTORY OF QUOTA TRADING AND QUOTA LEASING	10
FUTURE CHANGES	11
SPECIES	12
<i>Inshore Species</i>	12
<i>Deep-sea species</i>	13
<i>Crustacean/Molluscs</i>	14
FISHING TECHNIQUES	14
PROCESSING.....	15
RATIONALISATION	15
MARKET DEFINITION	16
INTRODUCTION	16
THE RELEVANT MARKETS	17
FINFISH MARKETS.....	18
<i>Product Markets</i>	18
<i>Functional Markets</i>	20
<i>Geographic Markets</i>	21
<i>Conclusion on Finfish Markets</i>	22
SHELLFISH MARKETS	22
<i>Product Markets</i>	22
<i>Functional Markets</i>	23
<i>Geographic Markets</i>	24
<i>Conclusion on Shellfish Markets</i>	24
CONCLUSION ON THE RELEVANT MARKETS.....	24
COMPETITION ANALYSIS	25
INTRODUCTION	25
THE MARKET FOR THE HARVESTING AND SUPPLY OF FINFISH IN NEW ZEALAND	26
<i>Existing Competition</i>	27
<i>Existing Competition</i>	29
<i>Constraint from Competition in Downstream Markets</i>	29
<i>Conclusion on Constraint from Existing Competition</i>	30
CONDITIONS OF ENTRY.....	30
<i>Individual Transferable Quota</i>	30
<i>Harvesting Capacity</i>	31

CONSTRAINTS FROM MARKET ENTRY	32
<i>Likelihood and Sustainability of Entry</i>	32
<i>Extent of Entry</i>	33
<i>Timeliness of Entry</i>	33
<i>Conclusion on Constraints from Market Entry</i>	33
CONCLUSION ON THE MARKET FOR THE HARVESTING AND SUPPLY OF FINFISH IN NEW ZEALAND	34
THE MARKET IN NEW ZEALAND FOR THE PROCESSING AND WHOLESALE SUPPLY OF FINFISH IN NEW ZEALAND (“THE PROCESSING MARKET”)	34
<i>Market Concentration</i>	34
<i>Constraint from Existing Competition</i>	36
<i>Potential Competition</i>	38
<i>Likelihood and Sustainability of Entry</i>	38
<i>Extent of Entry</i>	38
<i>Timeliness of Entry</i>	38
<i>Constraint from the Countervailing Power of Buyers</i>	38
<i>Conclusion on the Processing Market in New Zealand</i>	39
THE MARKET FOR THE PROCESSING AND WHOLESALE SUPPLY OF VALUE-ADDED FINFISH PRODUCTS IN NEW ZEALAND (“THE VALUE-ADDED MARKET”)	40
<i>Market Concentration</i>	40
<i>Constraint from Existing Competition</i>	40
<i>Potential Competition</i>	41
<i>Conclusion on the Value-Added Market in New Zealand</i>	41
THE MARKET FOR THE CULTIVATION AND SUPPLY OF GREENSHELL MUSSELS NEW ZEALAND	42
<i>Market Concentration</i>	42
<i>Existing Competition</i>	42
<i>Potential Competition</i>	43
<i>Regulatory Compliance</i>	43
<i>Capital Costs of Entry</i>	43
<i>The “Lets” Test</i>	44
<i>Conclusion on the “Lets” Test</i>	44
<i>The Countervailing Power of Buyers and Suppliers</i>	45
<i>Conclusion on the Market for the Cultivation and Supply of Greenshell Mussels in New Zealand</i>	45
THE MARKET FOR THE HARVESTING AND SUPPLY OF SCALLOPS IN NEW ZEALAND	45
<i>Market Concentration</i>	45
<i>Constraint from Existing Competition</i>	46
<i>Potential Competition</i>	47
<i>Conclusion on the “Lets” test</i>	48
<i>The Countervailing Power of Buyers and Suppliers</i>	48
<i>Conclusion on the Market for the Harvesting and Supply of Scallops in New Zealand</i>	48
THE MARKET FOR THE HARVESTING AND SUPPLY OF DREDGE OYSTERS IN NEW ZEALAND	49
<i>Market Concentration</i>	49
<i>Constraint from Existing Competition</i>	50
<i>Potential Competition</i>	50
<i>The “Lets” Test</i>	51
<i>Conclusion on the “Lets” test</i>	52
<i>Countervailing Power of Buyers and Suppliers</i>	52
<i>Conclusion on Market for the Harvesting and Supply of Dredge Oysters in New Zealand</i>	52
<i>Market Concentration</i>	52
<i>Constraint from Existing Competition</i>	54
<i>The “Lets” Test</i>	55
OVERALL CONCLUSION	56
DETERMINATION ON NOTICE OF CLEARANCE	57
APPENDIX A	58
APPENDIX B	59
DISSENTING OPINION OF K M BROWN AND E M COUTTS	60

THE PROPOSAL

- 1 In a notice to the Commission dated 7 March 2000, pursuant to section 66(1) of the Commerce Act (the Act), New Zealand Seafood Investment Ltd (NZSI) sought clearance to acquire a 100% share of Basuto Investments Ltd (“Basuto”). Basuto controls 50% of the shares in the Sealord Group Ltd (“Sealord”).

THE PROCEDURES

- 2 The application was received on 7 March 2000. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of two working days was sought by the Commission. Accordingly, a decision was required by 23 March 2000.
- 3 The applicant advised the Commission that its initial indicative bid for Basuto must be accompanied by any necessary clearances, and be submitted by 24 March 2000. For this reason, the applicant asked that the Commission treat the matter as urgent.
- 4 In the application NZSI sought confidentiality for sensitive commercial information contained in the application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission’s determination of the notice. When that order expires, the provisions of the Official Information Act 1982 will apply to the information.
- 5 The Commission’s determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.
- 6 In the course of the investigation, Commission staff discussed the application with a large number of parties, including fishermen, shellfish farmers, the Ministry of Fisheries, purchasers of fish and fish products, and fishery stakeholder companies.

THE PARTIES

- 7 There are many major parties within the fishing industry who will be affected by the acquisition. A diagram showing how the parties mentioned below are connected is attached in Appendix A.

New Zealand Seafood Investments Ltd

- 8 NZSI is an investment company, owned 50% by Amaltal Corporation Ltd (“Amaltal”) and 50% by Sanford Ltd (“Sanford”). It is being used as a vehicle for the purchase of Basuto and is not involved in fishing *per se*.

Amaltal

- 9 Amaltal was formed through a joint venture by Talley's Fisheries Ltd ("Talley's") and Amalgamated Marketing Ltd ("Amalgamated") in 1983. Talley's and Amalgamated each hold a 50% share. Amaltal is now reputedly New Zealand's third largest fishing company and is involved in the procurement and processing of deep-sea fish. It owns four freezer trawlers and several fresh fish trawlers with long-line capacities. Amaltal exports 99.2%, with the remaining 0.8% sold on New Zealand markets as fresh fish. Examples of the species it catches include hoki, orange roughy, oreo dory, squid, ling, and hake.

Talley's

- 10 Talley's was established in 1936 and is a private company owned by Peter and Michael Talley. Talley's own both inshore and deep-sea fishing vessels, mussel farms, cool-store facilities, and specialised fish processing factories. Talley's also contracts independent fishermen to harvest fish for it, and has significant holdings in other fishing companies.
- 11 Talley's harvest most commercial species, ranging from deep-sea fish such as orange roughy, to surface fish such as tuna, and shellfish such as scallops. Talley's also produces frozen vegetables and ice cream.

Amalgamated

- 12 Amalgamated is part of the Amalgamated Dairies Group which trades in primary products. Amalgamated is a holding company which does not involve itself in fishing *per se*. Amalgamated Dairies Group also holds a share of 48% in Sanford.

Sanford

- 13 Sanford is a listed company formed in 1881. Sanford owns a diverse fleet of vessels, fishing both inshore and deep-sea, and ten onshore processing plants. It trades in all types of commercial seafood including shellfish. Sanford is New Zealand's leading aqua-culturist (farmer of seafood) in terms of production volumes and varieties. In 1999 Sanford was ranked as the 65th largest company in New Zealand by Deloitte's Top 200 New Zealand Firms survey with revenues of \$335 million.

Basuto

- 14 Basuto is a holding company owned by Brierley Investments Ltd ("BIL"), and is being purchased for its 50% ownership of Te Ika Paewai Ltd ("TIP"). The other 50% of TIP is owned by Te Waka Una Ltd, a 100% owned subsidiary of the Treaty of Waitangi Fisheries Commission ("TOWFC"). TIP owns all shares in Sealord.

Sealord

- 15 Sealord specialises in deep-sea fish species, and is the largest quota holder in New Zealand. It is supplied by approximately 25 owned or leased fishing vessels. Sealord also have on-shore processing plants which prepare fish for export and domestic markets. In 1999 Sealord was ranked as the 49th largest company in New Zealand by Deloitte's Top 200 NZ Firms survey with revenues of \$473 million.

THE ASSOCIATION BETWEEN THE PARTIES

- 16 A preliminary question arises whether the applicant, its various shareholders, and the target company, should be treated as associated persons for the purposes of section 47. If so, then it would be necessary to treat all of these parties as “one head” in the market for the purposes of the application.
- 17 The applicant has argued that the general assumption by the Commission that a shareholding of 20% in a relevant company gives rise to association in terms of section 47(3), is too low.
- 18 The applicant has submitted that the thresholds set out in the article by Berry and Riley¹ should be used. The article posits a number of presumptions, which are rebuttable on the facts in each case. A substantial degree of influence is presumed to be likely to arise where the relevant shareholding is between 30 and 50%. The applicant has submitted that this assumption should be rebutted in the circumstances of this application where there is only one other shareholder with an equal and constraining power to ensure that neither 50% partner can exercise the level of influence envisaged under section 47(3).
- 19 The applicant also argues that by the time Talley's will be in a position to bring any influence to bear on Sealord, it will have an effective shareholding of only 12.5%.
- 20 The Commission must consider whether the applicant and any persons associated with it in terms of section 47(3) of the Commerce Act will have the ability to exert, either directly or indirectly, substantial influence over the activities of (1) the persons associated with it at the time of the application and (2) the target company. In this application, it is therefore relevant to consider the positions of influence of the shareholders in the applicant company and their interests in the relevant markets, and the competition effects of the amalgamation of their interests in the applicant with that of Sealords.
- 21 The Commission rejects the applicant's argument that Talley's and Amalgamated do not exercise substantial influence over Amaltal because the two equal shareholdings “cancel each other out”. On the contrary, here they are both 50/50 joint venture partners with a community of interest in the relevant markets, and all of the directors of Amaltal are appointees of Talley's and Amalgamated. In the present case emphasis must be given to the fact that Amaltal and Sanford are joint venture partners; they have equal representation and alternating chairmanship on the board of NZSI; they both have an equal ability to direct the policy, decision-making and operation of the applicant;

¹ Mark Berry and Anne Riley, “Beware the new business acquisitions provisions in the Commerce Amendment Act 1990” (1991) 21 VUWLR 91, 110.

and they have entered into this arrangement for the purpose of pursuing joint aims and ends. These factors, together with the levels of shareholding, provide reasons to conclude that the upstream shareholders of NZSI, identified in Appendix A, should be considered to be “associated persons” for the purposes of this application. In reaching this conclusion it is emphasised that various of these factors, such as the directorships and the ability to direct policies, are of greater significance than shareholding levels taken in isolation.²

- 22 The amalgamation of these interests would, in the Commission’s opinion, provide the applicant and its shareholders with the ability to exert a substantial degree of influence over Sealord via Basuto’s 50% shareholding of TIP.
- 23 Accordingly, the Commission proceeds on the basis that, for the purposes of this application, Amalgamated Dairies, Sanford, Talley’s and Sealord should be viewed as “one head” in the market in determining whether there will be, or will likely to be, the acquisition or strengthening of a dominant position in any of the relevant markets.
- 24 The Commission also notes that the level of shareholding required under the fisheries legislation for parties’ interests to be combined, is not relevant in determining “association” for the purposes of the Commerce Act. Throughout this decision, the parties listed in paragraph 23 are referred to as the “associated companies”.

OTHER RELEVANT PARTIES

Treaty of Waitangi Fisheries Commission

- 25 As party to the Treaty of Waitangi settlement, the Government set aside 10% of all TACCs to be distributed among Maori tribes (iwi). The Treaty of Waitangi Fisheries Commission (TOWFC) has been given the task of overseeing the management and distribution of quota. At this stage, iwi have been unable to agree among themselves on a fair way of allocating the quota and a resolution is not foreseeable in the near future. Until a decision is reached, the quota has been leased out at a discounted rate to iwi on a year-by-year basis.

Independent Fisheries Ltd (Independent)

- 26 Independent is a fishing and processing company formed in 1959. Independent’s main focus is on value-added products, such as crumbed squid rings and battered fish fillets, which are produced at its processing factory in Christchurch. Independent employs over 400 workers at this plant.
- 27 Independent is the fourth largest holder of hoki quota in New Zealand. It harvests this quota through a combination of its own deep-sea vessels as well as those chartered from Poland and the Ukraine.

² Ibid at p 114-115.

United Fisheries Ltd (United)

- 28 United was formed in 1975 and operates from Christchurch. It owns a large processing factory which produces mainly fish fillets, but also has significant capacity to produce value-added products. United owns only inshore vessels, so charters Ukrainian deep-sea vessels to harvest its quota for deep-sea species.

Simunovich Fisheries Ltd (Simunovich)

- 29 Simunovich is an Auckland-based firm, established in 1960. It has one of the largest fleets in New Zealand, comprising of both deep-sea freezer trawlers and inshore vessels. Simunovich also owns onshore processing factories. Simunovich's main product is scampi, but also it produces a variety of wet-fish products, including hoki and orange roughy fillets.

Vela Fishing Ltd (Vela)

- 30 Vela is one of the oldest fishery firms in New Zealand having been established in 1929. It owns two deep-sea trawlers which have on-board factories to process most of the fish. Vela is the fifth largest holder of hoki quota in New Zealand, and the hoki catch is processed into fillets and blocks.

BACKGROUND

Size of the Fishing Industry

- 31 The fishing industry is important to New Zealand in terms of export earnings and employment. In 1999, seafood exports accounted for approximately \$1.3 billion in revenue, making it New Zealand's fourth largest export earner behind dairy, meat, and forestry. The major exports are hoki, greenshell mussels, orange roughy, and crayfish. The seafood industry also provided around 40,000 jobs throughout the country. In the domestic market, sales of seafood amount to approximately \$150 million.
- 32 Currently, about 90% of all seafood harvested in New Zealand is exported, the major markets being Japan, United States, and Australia. This is the largest proportion of exports of any country except Iceland. Despite its export focus, New Zealand's seafood exports account for less than 1% of world seafood production.

History prior to the Quota Management System

- 33 Until 1978, New Zealand controlled a 12 mile exclusion zone around its coastline. Foreign vessels were not allowed to fish within this zone but were able to fish without limit outside it. During this time, deep-sea fish resources were greatly depleted by large overseas vessels.

- 34 In 1978, in recognition of rapidly falling fish stocks around the world, an international agreement allowed countries to establish a 200 mile Exclusive Economic Zone (EEZ), within which each country could control fishing. Because New Zealand has jurisdiction of several out-lying islands (such as the Chathams), New Zealand's EEZ is one of the largest in the world, covering 1.2 million square nautical miles.
- 35 By the 1980s, New Zealand's fish stocks were still falling, especially those of inshore species. As an attempt to preserve New Zealand's fish resources, a Quota Management System (QMS) was introduced in 1986.

Quota Management System

- 36 The QMS controls the amount of fish harvested commercially for all of the major species found within New Zealand's EEZ. Its purpose is to ensure that fish stocks remain at a sustainable level, and that no species is driven to extinction through over-fishing.
- 37 New Zealand's EEZ is broken down into several "management areas" for each species, and each year the Government, based on information about stock levels, determines the quantity of fish that may be caught of each species in each particular area.² Estimates of fish stocks are made by researchers appointed by the Ministry of Fisheries, and from research conducted by bodies within (and funded by) the industry itself. The Minister takes into consideration information from both sources, as well as the views of environmental, recreational, and Maori representatives, when making decisions about permitted catch sizes each year.
- 38 The quantity of fish of each species which may be caught is based on the concept of maximum sustainable yield (MSY). MSY is an estimate of the maximum amount of fish that can be caught, while still leaving sufficient stock to be able to sustain numbers through reproduction. This quantity is known as the Total Allowable Catch (TAC). The quantity of interest in this clearance application, however, is the Total Allowable Commercial Catch (TACC) which is simply the TAC after allowing for recreational fishing and customary Maori uses.

Individual Tradable Quotas

- 39 In 1986 the TACC for each species was broken down and allocated in the form of Individual Tradable Quotas (ITQs). These allocations were given in proportion to the historical catches of fishers, with those who had harvested the most getting the largest ITQs. The ITQs gave the owner the right to catch a certain tonnage of the TACC, in a given management area.
- 40 In 1990, the Government changed the quotas from a tonnage basis to a percentage of the TACC. This enabled the Government to change the TACC without the problem of having either to purchase or sell quota itself to meet the desired figure. This system places greater risk on the fishermen as it is they who will bear the burden when the

² An example of management areas is that for ling shown in Appendix B. Management areas vary from species to species.

TACC for a particular species is reduced. However, they also gain from any TACC increase.

- 41 If quota is overcaught substantially or fish is caught for which no quota is held, fishermen must pay a “deemed value” for the fish to the Ministry of Fisheries. The deemed value is set by the Ministry and is designed to eliminate any economic incentive to catch without quota.
- 42 One important aspect of the ITQs is that (as the name suggests) they are tradeable. Owners of the ITQs are free to sell, trade, or lease the quotas as they choose. Fishermen must *hold* quota to fish, either by owning it themselves or by leasing it from someone else. The ITQs represent a considerable asset to the owners.
- 43 The prices of buying and leasing quota have increased markedly since the inception of the QMS. In particular, the prices of by-catch quota, such as hake and ling, have risen to reflect a value far above the value of the fish *per se*. This probably reflects the requirement to have by-catch quota in order to catch the main species, such as hoki. The changes in price are illustrated in Tables 1 and 2 below. These reveal unexpectedly high prices for low value by-catch species such as hake and ling.

Table 1: Quota purchase prices for selected species/zone

Species/zone	Oct 1999 – Jan 2000	Oct 1986 – Jan 2000		
	Average (\$ per tonne)	Average (\$ per tonne)	Low	High
Hoki 1	2248	1639	2	11250
Hake 1	5000	3536	88	10000
Ling 1	8399	4410	1000	11000
Orange Roughy 3B	11380	8983	90	12000

Table 2: Quota annual lease prices for selected species/zone

Species/zone	Oct 1999 – Jan 2000	Oct 1986 – Jan 2000		
	Average (\$ per tonne)	Average (\$ per tonne)	Low	High
Hoki 1	172	288	2	650
Hake 1	426	445	10	1463
Ling 1	657	806	35	1500
Orange Roughy 3B	1096	997	2	3375

Recent History of Quota Trading and Quota Leasing

- 44 There is consistently a range of quantities of quota for different species that are on the market and are brokered through various companies or the fishing companies themselves. For the large quota areas and species, most quota is tightly held by a few

companies and there is little movement in it. This depends on the species; for some inshore species, particularly lobster, paua and some of the inshore finfish species there is quite a lot of trading activity in the market. For the big offshore species, such as orange roughy and hoki, there is little activity and most of it is done inhouse through companies.

- 45 There are a number of different commercial and strategic relationships between fishers and quota holders. Fishing operations may own or charter fishing vessels to fish their quota. In turn, the quota may be owned or leased. Quite often, fishers enter into FAAQH (Fishing Against Another's Quota Holding) agreements. In this case, having arranged a fishing permit, an independent fisher will harvest the quota held by another party. The quota holder will then control the landed catch. Once the fish has been caught, the FAAQH agreement has been satisfied. A FAAQH agreement will not show up as either a quota trade or lease transaction.

The Fisheries Act 1983

- 46 The Fisheries Act 1983 relates to the management and conservation of New Zealand's fishing industry. The Act created the Ministry of Fisheries, which in turn regulates the QMS. The Fisheries Act was amended in 1996, and it is understood that another amendment bill is currently under consideration.
- 47 Section 28w(a) of the Fisheries Act states that the maximum amount of the quota for a particular species/management area that an entity and its associates may hold is 35%. However, there is provision for this maximum to be exceeded given an exemption from the Minister, and it is understood that some companies currently have permission to hold up to 45%. If the Fisheries Act Amendment Act is enacted in its present form, the maximum quota holding will be increased to 45%. Companies can already be exempted, and some are, at the discretion of the Minister. This provision suggests that the Fisheries Act would serve to prevent a merger between two significant holders of quota, which leads to an aggregation exceeding that figure. It should be noted, however, that the association test specified in the Fisheries Act and used by the Ministry of Fisheries differs significantly from that used by the Commission under the Commerce Act. The Commission uses a test of "substantial influence", whereas the Ministry of Fisheries uses an "associated persons" test based on the aggregation of voting interests of the associates.

Future Changes

- 48 Presently the right to catch some seafood species is tied in with the long term property right inherent in the quota. In the future and under the new legislation, which is intended to come into operation on 1 October 2001, the two rights will become separate. There will be a new register established for quota, which will be the long term property right that can be mortgaged and officially borrowed against and for which there will be a secured right. Separate to that will be the ACE (Annual Catch Entitlement) register. At the start of the fishing year, a quota holding will generate a certain amount of catch right which can be traded and used quite separately from the quota, but it will only last one year. The proposed legislation will enable fishermen to enter the harvesting market by purchasing catch rights.

- 49 There will be a minimum amount of ACE required to go fishing but that will not be higher than current requirements, and therefore not a significant deterrent. The market will determine whether ACE can be purchased. If an owner does not want to sell it, they cannot be forced to do so. Catch rights will be similar to an annual lease, granting ownership rights, which can be on sold.
- 50 Currently quota is required to catch fish. One defence to catching fish without quota is the payment of the deemed value of the fish. In the future, there will be no criminal liability for failing to have ACE when fishing. It will be driven by the deemed value, so if a permit is obtained and the fisherman chooses to fish without ACE, nothing can be done except to levy the deemed value on the fisherman. The fisherman will make a choice as to whether to absorb the cost. For individual fishermen, there would be differing impacts. The vertically integrated companies with better margins will be able to sustain higher deemed value prices than those who are price takers. If the deemed value is set right, it should be a deterrent so that the ACE market is used and not the deemed value. The deemed value will drive the value of ACE.

Species

- 51 The fishing industry can broadly be divided into three main activities covering inshore species, deep-sea species, and crustaceans/molluscs. The data provided for respective TACCs, amount exported, and value of export gives an indication of the relative importance of each activity to the New Zealand fishing industry.

Inshore Species

- 52 Inshore species are defined as those found near the shore and down to 200 metres, and include: flounder, sole, snapper, john dory, groper, gurnard, butterfish, trevally, bluenose, tarakihi, blue cod, and monkfish. The current TACCs for major inshore species are listed below in Table 3.
- 53 New Zealand's traditional fisheries centre on the inshore species. They hold special significance for Maori and are obviously of importance to recreational anglers. In addition, because the species have historically been fished (and eaten), they are generally the preferred species for "white-cloth" fish dishes in New Zealand restaurants. In the North Island, restaurants typically offer groper, snapper, or tarakihi, while South Island restaurants tend to offer flatfish such as sole and flounder.
- 54 Vessels used to fish these species are relatively small. This is because the law prohibits the use of vessels longer than 43 metres fishing within 12 miles of the shore for environmental reasons.

Table 3: Major inshore species

Species	TACC (kg)	Value of Export (\$NZ)
Snapper	6,494,000	39,252,818
Trevally	3,880,634	7,530,606
Sole	6,535,566	5,974,964
Flounder	(for all flatfish)	5,667,160
John Dory	1,049,000	5,266,604
Groper	2,129,700	3,212,320
Tarakihi	5,930,000	798,232
Gurnard	5,056,754	532,743

Deep-sea species

- 55 Deep-sea species are defined as those that normally live at depths between 200 and 1200 metres, and include: hoki, orange roughy, hake, ling, oreo dory, squid, and silver warehou.
- 56 The New Zealand deep-sea fishery has been developed only over the last 20 years since the QMS was introduced. Initially, all deep-sea fishing was contracted out to overseas vessels. This was because deep-sea fishing vessels were highly technical, required a high level of expertise to operate, and were very expensive, and overseas markets were needed for the large quantities of fish caught. As the industry grew, however, New Zealand firms learned enough about the industry and accumulated sufficient capital to meet the cost of their own vessels. Currently, deep-sea fishing is done mostly by New Zealand owned and operated vessels, with some fishing contracted to foreign vessels.
- 57 Most deep-water vessels currently in operation are completely self-contained, having processing, packing, and freezing facilities on-board. This ensures that the fish is of a high quality, as the fish is processed as soon as it is brought on-board.
- 58 The development of deep-sea fishing has been largely responsible for the rise in export earnings over the last twenty years. Deep-sea species provide significantly more export revenue than inshore species, because the stock numbers are higher, and they command much greater demand overseas. Of those species, it is generally accepted that hoki is the most important, accounting for just under \$300 million per year in export revenue.

Table 4: Major deep-sea species

Species	TACC (kg)	Value of exports (\$NZ)
Hoki	249,932,970	299,893,642
Orange Roughy	20,345,780	102,892,045
Hake	14,057,540	36,701,845
Ling	22,003,900	59,418,580
Oreo Dory	23,934,000	27,698,306

Crustacean/Molluscs

- 59 This category includes shellfish species such as oysters, scallops, and mussels, and crustacea such as the spiny rock lobster and crab.
- 60 In terms of revenue, the shellfish industry has grown significantly in recent years, particularly the output of mussels. This is has been mainly due to the development of farming techniques (“aquaculture”) for shellfish, which has meant that large quantities can be supplied on demand to overseas buyers. Mussel exports have increased from \$2.6 million in 1981, to \$34 million in 1990, and to \$117 million in 1999.

Table 5: Major molluscs/crustacean species

Species	TACC (kg)	Value of Exports (\$NZ)
Pacific Oysters*	No TACC	10,134,486
Scallops	826,000	24,565,125
Mussels**	No TACC	116,894,894
Spiny Rock Lobster	2,833,417	115,666,855

* Pacific oysters are farmed so are not subject to quota. No Bluff or Nelson oysters are exported.

** Mussels are farmed so are not subject to quota.

Fishing Techniques

- 61 Fishing techniques vary depending on the type of fish being harvested, the most common method being trawling.
- 62 Trawling is the dominant form of fishing major inshore and deep-sea species. The technique involves one or two boats dragging an elongated net through the water where the fish are schooling. Vibrating ropes encourage fish between the boat and the net to swim in the net’s path rather than away.
- 63 In the past trawling has been rather “hit-and-miss”, but with modern technology it has become much more precise. Sonar and radar can accurately determine the size of the school of fish, their location, and their depth in the water. Despite the technology, a certain amount of “by-catch” unavoidably gets caught by the trawl nets.
- 64 Netting involves stretching a net across an area and catching all fish above a certain size that swim into it. The net is kept upright by a series of floats along the top and weights on bottom. By using lighter weights the net can be used to catch surface fish, while using heavier weights will allow the fishermen to catch deeper dwelling fish. Netting is considered one of the most selective of all fishing methods, as the size of the mesh can determine the size and type of fish caught.
- 65 Long-lining involves the use of a series of lines with baited hooks. Long-lining can be used on the surface or on the seabed depending on the type of fish being harvested.

- 66 Squid jigging is the method used to catch squid. Squid are encouraged to gather under the boat at night by bright lights shone across the water, and are hooked on lines containing a series of lures dropped down the side.
- 67 Dredging is used to collect scallops and oysters. The system involves a steel framed dredge being dragged across the ocean floor. The shellfish are picked up and then sorted on-board.
- 68 Greenshell mussels are farmed on ropes suspended in the water by floats. There is one long-line that runs across the surface, generally several kilometres long. From this shorter ropes drop down into the water in loops, on which the mussels grow.

Processing

- 69 Processing can occur either on the vessel itself or onshore. Inshore vessels are relatively small and so do not have on-board processing facilities. Typically, therefore, they will spend one or two days fishing before returning to port to unload the fish they have harvested for processing. Their catch is chilled while at sea to maintain freshness.
- 70 Most deep-sea vessels have on-board factories and process the fish as soon as it is caught. Immediate processing ensures that the fish retains its flavour, and avoids the need to freeze it, thaw it on-shore for processing, and then refreeze it for export. The factories also pack the fish, leaving the product ready for export as soon as its landed. Fish by-products such as fish meal are also produced. The deep-sea vessels employ up to 60 staff, working 6 hour shifts, 24 hours per day.
- 71 Onshore processing factories are similar to on-board factories but are typically of a larger scale. Both onshore and on-board factories have expensive automated systems that remove the head, tail, spine, and skin as well as coat the fish for value added products. The process is, however, still quite labour-intensive, as workers still gut, fillet, and pack the fish.
- 72 The main product is fillets (in various forms) but a significant share of fish is used to make fillet block. Fillet block refers to a large frozen block of packed fish. This block can then be divided up as required using a “bandsaw” type cutter, for use in value-added products.
- 73 Value-added products refer to seafood that has been “enhanced” in some way to increase its value. This might include battering or crumbing the fish, adding a sauce, or mincing it and reshaping it. There is a plethora of different value-added products including fish fingers, fish burgers, fish cakes, squid rings, seafood sticks, scallop bites, and the like. These products are typically marketed under a brand name. All value-added processing is done onshore.

Rationalisation

- 74 Deep-sea and inshore fisheries have developed very differently. Because inshore species had been fished for a long time and had relatively low capital costs for entry, the introduction of the QMS dispersed the ITQs to a wide range of small fishing

operations. Today the market is extremely fragmented with no fishing entity holding a significant share of the TACCs for in-shore fishing.

- 75 In contrast, deep-sea fishing requires highly technical, expensive equipment. The cost of a deep-sea vessel (up to \$40 million for a new vessel) is typically out of reach for all but the very largest firms in the industry. Smaller quota holders can contract foreign firms to harvest fish for them, but it has been the larger firms that own large shares of quota, and have their own vessels and processing facilities, that have grown the quickest, benefiting from scale economies and being able to control fish flows.

MARKET DEFINITION

Introduction

- 76 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.
- 77 Section 3(1A) of the Act provides that:
- “... the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.”
- 78 Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,³ and in the Commission’s *Business Acquisition Guidelines* (“the Guidelines”).⁴ A brief outline of the principles follow.
- 79 Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products which are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.
- 80 A properly defined market includes products which are regarded by buyers or sellers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market

³ (1991)4 TCLR 473.

⁴ Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a “small yet significant and non-transitory increase in price” (the “*ssnip*” test), assuming that other terms of sale remain unchanged.

- 81 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the “manufacturing market”, while that between wholesalers and retailers is usually known as the “wholesaling market”.

The Relevant Markets

- 82 The applicant has claimed, on the basis of the common business activities of Amaltal, Sanford and Sealord, that there are three markets where aggregation would occur as a result of the proposed acquisition, as follows:
- markets for the procurement of finfish for processing in New Zealand;
 - markets for the procurement of shellfish for processing in New Zealand; and
 - markets for the supply or distribution of finfish and shellfish in New Zealand.
- 83 It is not clear why the term “market” is used in the plural in the above definitions. In the finfish procurement markets, for example, this could imply that there are separate markets for deep-sea and inshore fishing, or for different species. Both of these aspects are mentioned in the explanation of the market, although neither is actually built into an elaborated market definition. However, in the last market, the applicant does distinguish two separate “sectors”, namely the “processed/frozen retail market sold in supermarkets”, and the “food service/fresh/restaurant market”.
- 84 Following the Commission’s earlier decision in *Treaty of Waitangi Fisheries Commission/Salmond Smith Biolab* (AUT/BA-T13/1, 6 September 1995), the applicant considers that the markets for the sale and purchase of ITQs, and the leasing of ITQs, need not be considered as their operation is governed by the *Fisheries Act*. The Commission understands that the aggregation levels of quota under the Fisheries Act are not actively policed, although the penalties for breaching the levels are high. In any case, such aggregation still falls to be considered under section 47 of the Commerce Act. The Commission also notes that the need to obtain ITQs is a regulated, structural feature of the markets and a condition of entry into fishing. Quotas are dealt with in the discussion on competition below.
- 85 The Commission considers that the applicant’s proposed definitions are too aggregated, both in relation to products and to functional market levels, but has found it difficult to define precise boundaries for the relevant markets in this case. The difficulties stem from a number of factors, including the following: the limited timeframe available to investigate the issues raised by the application; the difficulty of obtaining comprehensive information on what is a large and diverse industry; the complications

introduced through the regulation of the industry by the QMS; and the determination of how the variety of fish and fish products fit within the wider spectrum of consumer foods. Hence, the Commission has adopted a pragmatic approach using the information available (collected from a number of industry participants), and largely restricting the analysis to those markets where the proposed acquisition would lead to aggregation of market share. The difficulties noted have resulted in a tendency to define the markets rather broadly, so possible limitations in the definitions used are also noted.

- 86 In what follows, the markets will be considered in two groups: those for finfish, and those for shellfish.

Finfish Markets

Product Markets

- 87 The applicant, in its market definitions, has proposed two product markets, namely those for processed finfish and processed shellfish, but has not elaborated as to the reasons for this distinction. There appears to be an implication that canned fish, crustaceans and salmon are not included, although this is not explicitly stated. A separate market for so-called “value added” or manufactured fish products is not mentioned.
- 88 The Commission has found that finfish species form neither an homogeneous group, nor discrete groupings of ‘high value’ and ‘low value’ species, but rather are graded over a range of quality, and hence of price. One Wellington fish wholesaler and retailer estimated the retail price ranges by major species in mid-March as follows:

John dory, blue cod, orange roughy	\$20-25/kg
Grouper, snapper	\$18-22/kg
Tarakihi	\$15-17/kg
Blue warehou, trevally	\$11-13/kg
Hoki, red cod	\$8-10/kg

- 89 One of the applicants—Talley’s—has provided the Commission with its frozen food price list for catering distributors, effective from 1 December 1999. A sample of these wholesale prices per kilogram (excluding GST) for a range of skinless/boneless fillets (based largely on 10 kilogram pack sizes) is as follows:

Orange roughy	\$16.00
Snapper	\$13.00
Groper, bluenose	\$12.00
Tarakihi	\$9.50
Rig	\$9.30
Turbot	\$8.50
Brill	\$8.00
Lemon fish (avge.)	\$7.85
Ling	\$7.00
Red cod (avge.)	\$6.65
Hoki	\$6.00
Blue warehou, travally, cardinal	\$5.50

- 90 From a demand-side perspective, it is unlikely that, say, orange roughy and hoki compete closely one against the other, but it is likely that each will compete with others at its price level and in the immediately adjacent price level. For example, for those consumers who buy premium quality fish, it seems likely that snapper will be a substitute for orange roughy, but not hoki, in the event that the price of orange roughy were to rise. This overlapping substitutability between species at adjacent quality/price levels should result in a chain of substitutability stretching from the premium quality to the budget quality species. On this basis, all major finfish species would fall within the same product market. This conclusion has been supported by a range of parties within the industry.
- 91 An argument that has been considered is that as the industry is split into inshore and deep-sea fishing, with very different technologies and entry costs being required in each, this might lead to a differentiation of markets for inshore species such as red cod and grouper from that for deep-sea species such as hoki and orange roughy. However, while the industry is characterised by this supply-side differentiation, it would have no bearing on the product market definition if, as assessed, the inshore and deep-sea species compete one with another for the consumer dollar. Thus, a hypothetical monopolist in, say, the deep-sea fishery could not, in those circumstances, exert market power by raising the price of the deep-sea species, because it would lose sales to suppliers of the inshore species. In addition, some deep-sea species such as orange roughy and hoki are caught in inshore waters as a by-catch, and the hoki spawning ground fishery in the south-east approaches of the Cook Strait is an inshore fishery. For these reasons, there appears to be no basis for distinguishing separate product markets according to supply-side factors.
- 92 The Commission has also considered whether there might be a separate product market for hoki. This would rest on the fact that hoki is easily the most important species in both tonnage and value terms, comprising about 40% of the total tonnage landed of about 600,000 tonnes. A large part of the catch is made in the deep-sea fishery by factory freezer trawlers, which process it onboard. Hoki is by far the most important export species, and is the major species used in the manufacture of value-added fish products. It is conceivable that a company which, hypothetically, gained control of the quota for hoki might be able to exert market power, simply because no other species could provide the volumes of fish required. However, the Commission notes that the tonnages used in the domestic market are much smaller, and that other species with substantial quota volumes such as southern blue whiting, warehou and trevally are used for value added fish products besides hoki. Hence, it appears unlikely that there could be a separate hoki-based market in New Zealand.
- 93 The Commission proposes to exclude salmon from its assessment of this application. It takes this view because salmon appears to be a specialist “niche” market, as opposed to the more general “finfish” products. Further, salmon is farmed and is not subject to quota, unlike other finfish. Finally, of the associated companies, only Sanford has an involvement in salmon processing. Therefore, there will be no aggregation in salmon-related activities. For these reasons, the Commission considers that it is appropriate to exclude salmon from its analysis of this current application.

- 94 For the retail buyer and end consumer, finfish as a product may be distinguished by the degree of processing it has undergone. In general terms, there appear to be two major categories: ‘basic processed’ product, where the finfish is marketed as wet fish, either whole, or in fillets (although it may have been frozen at an intermediate stage); and manufactured or ‘value-added’ product, where it has undergone further processing into crumbed and breaded fillets, and into frozen, branded products such as fish fingers, burgers, bites, and cakes. Some of the latter products are manufactured either from minced fish, or from frozen “fish blocks”—made from compressed and frozen off-cuts of filleted fish—and band-sawed piece-by-piece into the required size. The hoki is used extensively in the production of value-added fish products, but other species such as hake, john dory and snapper are also used.
- 95 The fresh, basic processed, product is important for restaurants, fish and chip shops, seafood shops and (to a degree) for supermarkets. The value-added, branded products are marketed predominantly through supermarkets and other retail outlets as convenience food items. This suggests that there are two end-product markets, the first for fresh, basic processed finfish, and the second for value-added finfish products. The latter are likely to meet at least some competition from other processed, frozen convenience, meat products such as chicken fingers, bites and patties, but the Commission has not been able to determine in the time available whether there is a wider product market encompassing all of these products.
- 96 The Commission concludes that for the purpose of assessing the competition implications of the proposed acquisition, the relevant product markets are for processed finfish (excluding salmon), and for value-added finfish products (excluding canned finfish).

Functional Markets

- 97 As indicated earlier, finfish pass through various stages, or functional levels, from the point of harvest to the consumer. The functional levels of the market are harvesting; basic processing; value-added processing; and distribution (including exporting).
- 98 Harvesting of finfish is undertaken by both deep-sea and inshore boats, as already noted. In general, the former are much larger vessels, which travel much farther to the fishing grounds, and stay at sea for much longer – often for several weeks at a time. They may also have onboard processing of the catch. The inshore boats often fish on a day-by-day basis, and are less able to cope with bad weather. Hence, the two fleets are not interchangeable. Indeed, participants from within the fishing industry have commented that it would not be economic to employ a large, capital-intensive, deep-sea vessel in an inshore fishery. In any case, regulations prevent such vessels from fishing within 12 miles of New Zealand’s coastline. Nonetheless, the two fleets effectively compete because the fish they harvest are substitutable in the manner described above. Hence, there is likely to be a generic harvesting functional market, even though the technologies and entry costs differ substantially between the inshore and deep-sea fleets.
- 99 The processing market involves processors receiving whole fish supplied through the catching process. On the demand side, there are no close substitutes for finfish as an input into modern processing. Processing may be undertaken by the fisher, a land-

based processing plant, or by the whole-fish customer such as a fish shop or restaurant. Processing plant is designed specifically for handling fish, with both manual and automated lines removing the head, tail and entrails of the raw fish, then filleting and freezing the product. The automated lines can be calibrated to handle a range of species and sizes within certain tolerances, but remain specialised and unable to process non-fish products.

- 100 Substantial further investment in plant and marketing is required to produce value-added finfish products. Continuity of supply is important for this processing, though stocks of frozen fish can be held for periods of 12-18 months, albeit at a significant cost in terms of the specialised refrigerated storage required. Only a few of the largest fishing companies are present in this value-added market.
- 101 A complication for market definition is the vertical integration across functional levels. For example, in the deep-sea fishery, the catch is often processed at sea. Most of the catch is harvested by large factory freezer trawlers, which at least partially process and freeze the catch immediately. For premium hoki fillets it is critical that the catch is processed and frozen within half-an-hour. Fish blocks are also produced. The product is then either distributed, including for overseas sale, or further processed onshore.
- 102 The largest operators tend to be vertically integrated across all functional levels. They harvest fish using owned quota and boats, process the catch themselves, and distribute and market the product also. However, in other cases, companies may lease quota to independent fishers who supply their catch to the leasing company, or independent processors may rely on others to supply their finfish input. Many small fishers have no connection with processing other than supplying the raw fish. Hence, there appears to be sufficient vertical disintegration in the industry for it to be appropriate to treat each functional level as a separate market.
- 103 The Commission concludes that the relevant functional levels of the market are for the harvesting, processing and value-added manufacturing, of finfish.

Geographic Markets

- 104 The applicant has asserted that the relevant geographic market is the whole of the country. The Commission's investigations suggest that the geographic dimensions of the markets are at least national in extent.
- 105 With regard to harvesting, quota by species relates to particular management areas, and onshore processing facilities tend to receive fish from vessels fishing the adjacent regional waters, particularly for inshore species. Thus, there are regional differences in the domestic market with, for example, snapper being more prevalent in Auckland, tarakihi in Wellington, and flatfish species in Christchurch. This appears to reflect regional differences in species availability, and consequently differences in consumer tastes. However, harvesting and processing companies do transport catch around the country, or acquire fish from other fishing companies—and this includes fish being transported between the South and North Islands—in order to reduce regional discrepancies between supply and demand, and to smooth out seasonal fluctuations in supply.
- 106 In the case of processing and wholesale supply, finfish in both fresh, frozen and processed forms are transported around the country, and a very large proportion of the

industry's output is sold overseas. Hence, the market is at least nationwide in extent. Under the terms of section 3(1A) of the Act, the market cannot be wider than New Zealand, and hence imports and exports have to be incorporated in the evaluation of competition in the relevant markets.

- 107 The Commission has concluded that the geographic extent of all of the relevant finfish markets is New Zealand-wide.

Conclusion on Finfish Markets

- 108 The Commission considers that the following finfish markets are relevant for the consideration of the present proposal:

- the market for the harvesting and supply of finfish in New Zealand (the 'harvesting market');
- the market for the processing and wholesale supply of finfish in New Zealand (the 'processing market'); and
- the market for the processing and wholesale supply of value-added finfish products in New Zealand (the 'value-added market').

Shellfish Markets

Product Markets

- 109 Previous Commission decisions have defined the relevant domestic product markets for shellfish as including the procurement, processing and supply of the products of separate shellfish species.⁵ The Commission's investigation in the present case, which has involved greenshell mussels, scallops and dredge oysters, has confirmed that different shellfish are likely to fall into different product markets.
- 110 Greenshell mussels are a species native only to New Zealand, and are farmed in the sheltered waters of the Marlborough Sounds, Golden Bay and the Hauraki Gulf. A line of buoys is anchored to the sea floor which support a "long-line" on the surface, from which hang vertical growing lines at intervals. Greenshell mussels are mostly sold in the half-shell form in export markets, and in the marinated form and as mussel meat domestically. On the demand side the retail product is assumed to be homogeneous, notwithstanding the fact that mussels are sold in many forms.⁶ The blue mussel, which is not native to New Zealand, is smaller than the greenshell mussel and its meat has a different texture, but it is commonly regarded as a substitute for it. The blue mussel is supplied to the New Zealand market by domestic supply and imports, but the quantity is relatively small. Mussels make up the bulk of the shellfish harvest, and a large proportion are exported.
- 111 Unlike greenshell mussels, which are farmed, both scallops and dredge oysters are subject to the QMS, and the tonnages produced are much smaller. Both of these shellfish species are harvested using the dredging technique, whereby a meshed dredge

⁵ *Treaty of Waitangi Fisheries Commission/Salmond Smith Biolab* (AUT/BA-T13/1, 6 September 1995).

⁶ B M H Sharp, "Fishing", in A Bollard and M Pickford (eds) *The Structure and Dynamics of New Zealand Industries*, Dunmore Press, Palmerston North, 1998) p 67.

is dragged along the sea floor by a boat. Dredge oysters are harvested on a seasonal basis in the two quota management areas around Nelson and Bluff, and all are consumed domestically.

- 112 Evidence supplied to the Commission by different market participants and interested parties suggests that from a demand-side perspective, mussels, scallops and oysters are not substitutes one for another. The mussel is a lower priced product relative to the other two (and to paua), and it has different consumption characteristics. Scallops and dredge oysters are highly valued and high priced shellfish which are considered to be differentiated from other shellfish species, and each other, by their unique characteristics. Evidence from the market suggests that the pricing and performance characteristics of the three shellfish species are such that they occupy separate product markets.
- 113 On the supply-side, production of each species tends to be quite location-specific. Mussels are distinguished by their mode of cultivation from the harvesting approach used for the other two shellfish species, and there is no substitutability between the two methods of production. Mussel producers cannot easily switch to producing the other two species, and vice versa. Switching between scallops and dredge oysters is possible from a technical point of view, but is inhibited by the need to acquire the necessary quota. Thus, the QMS would prevent operators switching between scallops and oysters (although quota has been traded), and neither would be able to switch production to mussels in a timely manner without significant new investment in plant and equipment. Further, Pacific oysters are generally farmed in inter-tidal areas using a different 'rack' system. Although it is not determinative, the three species of shellfish are thus also differentiated on the supply-side.
- 114 The Commission concludes that there are separate product markets for mussels, scallops and oysters.

Functional Markets

- 115 The functional levels of the market is that for the cultivation (in the case of mussels) or harvesting (in the case of scallops and dredge oysters) and supply of the three types of shellfish, and that for the processing of shellfish. For all three species, in some instances, vertical integration means that these functions are integrated within the firm, but there is also a considerable volume of external transactions because of the large number of independent cultivators who lack any processing capacity. Hence, harvesting and processing can be distinguished as separate functional levels in the market.
- 116 The processing of different species of shellfish involves similar resources and competencies, and requires a licence from the Ministry of Fisheries. Scallops and oysters are opened by skilled processors in a controlled environment in which the maintenance of very high hygiene standards is important. They are supplied as "meat" or in their half shells.
- 117 The processing of mussels requires additional resources to that required for scallops and oysters. The mussels are washed, graded by hand and their "beards" are removed mechanically. The mussels are then cooked, have one shell removed manually if sold

as “half shell”, or go through a mechanical shaker where the meat is removed from the shell. They then can be sold as mussel meat, be marinated, or go through further processing. This further degree of processing compared to scallops and oysters, increases required capital investment. Nonetheless, about 40% of mussel processors are also involved in the processing of other shellfish, suggesting that all three shellfish species can be processed through the same or similar facilities. The processed shellfish are then distributed to the domestic and overseas markets.

- 118 The Commission concludes that there are two functional levels of the shellfish product markets, namely those for the cultivation/harvesting and supply of the relevant shellfish, and for the processing and wholesale supply of shellfish.

Geographic Markets

- 119 Generally, shellfish are processed at plants near the source of supply. However, as a relatively high-value, low-bulk product they can be transported comparatively inexpensively using refrigerated transport. For example, in the case of mussels, the largest producing area—accounting for 77% of total production in the year to 31 March 1998—is the Marlborough region. Nearly half of this production was transported out-of-region for processing, with about 15% being processed in the Canterbury region, 30% in Nelson, and about 1.5% in the Hauraki region. This level of internal transportation of mussels for processing suggests that the market is a national one. Once processed, the product is distributed nationally and internationally.
- 120 The Commission concludes that the geographic dimension of the market is nation-wide.

Conclusion on Shellfish Markets

- 121 The Commission considers that the following shellfish markets are relevant for the consideration of the present proposal:
- the cultivation and supply of greenshell mussels in New Zealand;
 - the harvesting and supply of scallops in New Zealand;
 - the harvesting and supply of dredge oysters in New Zealand; and
 - the processing and wholesale supply of shellfish in New Zealand.

Conclusion on the Relevant Markets

- 122 On the basis of the analysis above, and on the information currently available, the Commission has reached the conclusion that the relevant markets for the purposes of analysing the competition issues arising from the proposed merger are the following:
- the market for the harvesting and supply of finfish in New Zealand (the ‘harvesting market’);
 - the market for the processing and wholesale supply of fresh finfish in New Zealand (the ‘processing market’); and
 - the market for the processing and wholesale supply of value-added finfish products in New Zealand (the ‘value-added market’).

- the cultivation and supply of greenshell mussels in New Zealand;
- the harvesting and supply of scallops in New Zealand;
- the harvesting and supply of dredge oysters in New Zealand; and
- the processing and wholesale supply of shellfish in New Zealand.

COMPETITION ANALYSIS

Introduction

123 According to section 47(1) of the Commerce Act,

“No person shall acquire assets of a business or shares if, as a result of the acquisition, -

- (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
- (b) That person’s or another person’s dominant position in a market would be, or would be likely to be, strengthened.”

124 Section 3(9) of the Commerce Act states that:

“For the purposes of sections 47 and 48 of this Act, a person has, or 2 or more persons that are interconnected or associated together have, as the case may be, a dominant position in a market if that person as a supplier or acquirer, or those persons as suppliers or acquirers, of goods or services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market ...”

125 That section also states that a determination of dominance shall have regard to:

- (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons;
- (b) The extent to which that person is, or those persons are, constrained by the conduct of competitors or potential competitors in that market;
- (c) The extent to which that person is, or those persons are, constrained by the conduct of suppliers or acquirers of goods or services in that market.”

126 In the Commission’s view, as expressed in its *Business Acquisitions Guidelines 1999* (page 17), a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:

- The merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market; or
- The merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market, and faces competition from at least one other market participant having no less than in the order of a 15% market share.

127 The test for dominance has been considered by the High Court. McGechan J stated:⁷

“The test for ‘dominance’ is not a matter of prevailing economic theory, to be identified outside the statute.”

...

“Dominance includes a qualitative assessment of market power. It involves more than ‘high’ market power; more than mere ability to behave ‘largely’ independently of competitors; and more than power to effect ‘appreciable’ changes in terms of trading. It involves a *high degree of market control*.”

128 Both McGechan J and the Court of Appeal, which approved this test,⁸ stated that a lower standard than “a high degree of market control” was unacceptable.⁹ In its *Business Acquisition Guidelines 1999* (page 21) the Commission has acknowledged this test:

“A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction.”

“A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability.”

129 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

130 The Commission applies the dominance test in the following competition analysis.

The Market for the Harvesting and Supply of Finfish in New Zealand

131 In considering whether the proposal might lead to the acquiring or strengthening of a dominant position in a market, the Commission takes into account the extent of rivalry within the market and the constraint provided by the threat of new entrants. There may also be some constraint in the form of countervailing market power in the hands of customers and/or suppliers. These factors are considered below.

132 In addition to adopting the broad market definition of finfish, a separate analysis of hoki is also provided. As noted in the earlier section on market definition, this is in recognition of the particular importance of the hoki fishery to the New Zealand fishing industry, in particular to the value-added market. The hoki TACC (250,000 tonnes out of a total finfish TACC of approximately 600,000 tonnes) is easily the largest for any

⁷ *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC).

⁸ *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA).

⁹ *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC) and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA).

finfish species in New Zealand. The next largest finfish TACCs are for jack mackerel (60,547 tonnes) and southern blue whiting (58,000 tonnes). Combining the TACCs for the important orange roughy, hake and snapper fisheries amounts to just under 41,000 tonnes.

Existing Competition

Market Concentration

- 133 An examination of market concentration often provides a useful first indication of whether or not a merged firm may be constrained by other participants, and thus the extent to which it may be able to exercise market power.
- 134 In examining market concentration, the Commission has developed a set of 'safe harbours' (see above). These safe harbours recognise the importance of both the absolute levels of market share and the distribution of market shares between the merged entity and its competitors in determining the extent to which rivals are able to constrain the behaviour of the merged firm.
- 135 If, given an appropriate definition of markets and market shares, a proposed acquisition falls within these safe harbours, the Commission will usually grant approval. If, however, the acquisition falls outside of these harbours, the Commission will consider a range of additional factors before drawing conclusions on market dominance.
- 136 Prior to discussing market shares for the harvesting and supply of finfish in New Zealand, it should be recalled that about 90% of all seafood harvested in New Zealand is exported. Thus, these market shares taken in isolation are not necessarily reflective of potential dominance concerns within New Zealand. In this context the ability of suppliers other than the associated companies to satisfy domestic demand is of particular relevance.
- 137 Tables 6 and 7 set out the main owners and holders of total finfish quota, and of hoki quota, respectively. The tables aggregate the ownership and holdings contained in the Ministry of Fisheries quota database. The tables provide a snapshot of quota ownership and quota holdings as of 21 March 2000.

Table 6: Quota Ownership and Holdings (Total Finfish)

	Total Quota Owned (tonnes)	Market Share	Total Quota Held (tonnes)	Market Share
Sealord/TIP	134,492	23%	128,596	22%
Sanford	110,901	19%	112,342	19%
Amaltal	63,326	11%	51,906	9%
Talleys	17,641	3%	16,622	3%
Associated Companies	326,360	56%	309,466	53%
TOWFC	67,849	12%	11,620	2%
Independent	38,910	7%	43,255	7%
Vela	32,389	6%	21,498	4%
United	19,113	3%	14,394	2%
Moana Pacific	7,357	1%	15,181	3%
Other	89,256	15%	165,820	29%
Total	581,234	100%	581,234	100%

138 According to Table 6, the associated companies would *own* 56% of the total finfish quota. This situation falls just outside the safe harbours, as the market share of the largest rival is the 12% owned by the Treaty of Waitangi Fisheries Commission (TOWFC).

139 Table 6 also shows the concentration of quota *holdings*. Quota held includes quota owned and fished, as well as quota leased in from other parties. Quota held will therefore tend to better reflect harvesting capacity. The associated companies would *hold* 53% of total finfish quota. This again falls outside the safe harbours.

140 Turning specifically to the hoki fishery, Table 7 shows the ownership and holdings of HOK1 quota. The hoki fishery in New Zealand is covered by the single QMA 1. The associated companies would *own* approximately 64% of HOK1 quota, and would *hold* 62% of HOK1. The next largest ownership share of HOK1 is the 10% owned by TOWFC, and the next largest holding is Independent's 10%.

Table 7: Quota Ownership and Holdings (HOK1)

	Total Quota Owned (tonnes)	Market Share	Total Quota Held (tonnes)	Market Share
Sealord/TIP	75,706	30%	75,431	30%
Sanford	35,100	14%	37,100	15%
Amaltal	42,286	17%	34,785	14%
Talleys	6,738	3%	6,816	3%
Associated Companies	159,830	64%	154,132	62%
TOWFC	24,993	10%	-	-
Independent	19,674	8%	23,855	10%
Vela	17,918	7%	15,018	6%
United	5,129	2%	4,955	2%
Moana Pacific	867	0%	2,876	1%
Other	21,589	9%	49,164	19%
Total	250,000	100%	250,000	100%

- 141 In general, quota holdings will roughly reflect catch levels, bearing in mind that the under- or over-catching of quota by 10% can be transferred from one year to the next.

Existing Competition

- 142 The Treaty of Waitangi Fisheries Commission owns 12% of the total quota. TOWFC was established as the vehicle for receiving, and allocating to iwi, quota as the basis of the full and final settlement of Maori claims to sea fisheries. The settlement includes 10% of all existing TACCs, 20% of the TACCs for any new species added to the Quota Management System, and 50% of Sealord. However, TOWFC's quota will eventually be distributed to iwi groups, and therefore will be spread across a diverse base. It is currently leased out to Iwi groups on an annual basis.
- 143 The next largest parcels of quota are owned by Independent (7%) and Vela (6%).
- 144 In considering the market shares as an indicator of ability to exert market control, reliance is implicitly placed on the ability of rivals to respond to any increase in prices. However, a peculiar feature of the finfish harvesting market is the supply rigidity set by the TACC. This has the effect of limiting the supply response of other companies in a situation where one company, having aggregated quota, seeks to exploit its potential market power by restricting output and raising prices. Normally, the output-restricting power of such a company would be limited or nullified by the ability of other sizeable producers to expand production, thereby maintaining market supply.
- 145 This is not possible with finfish harvesting, where the output of rival companies is absolutely restricted by the quota system (unless their quota was to some extent undercaught, thus allowing them to expand production within existing quota holdings). Hence, in the absence of external effects - such as export diversion or imports in downstream markets - a single large firm may be able to exert significant market power, and hence be dominant, at a much lower level of market share than would normally be the case.
- 146 However, notwithstanding this restriction, of particular significance is the size of rivals' quota relative to the domestic demand. The Commission considers that this is an unusual case in which conventional output restriction concerns need not be given too much weight. Of particular relevance is the question of the associated companies' ability to raise prices above the export price, and the likely response of incumbent rivals. These issues are considered further below.

Constraint from Competition in Downstream Markets

- 147 The extent to which a harvesting firm could exploit market power is likely to be capped as a result of competitive forces at play in the processing and wholesale markets. These forces include the possibility of export diversion and/or imports. The role of imports is more fully discussed later in this decision. Although the line between harvesting and processing in the fishing industry has been considerably blurred due to the nature of processing methods, any attempt by a harvester to extract higher landed fish prices from processors would at some point lead to a switch towards semi-processed imports.

- 148 The potential for rival companies to divert product from export markets to the domestic market will reinforce this constraint, and a number of companies have indicated that they would divert exports in response to a favourable change in relative prices. There may be some potential for this to occur directly in the harvesting market, given that some fish is exported whole in a largely unprocessed state.
- 149 The Commission considers export diversion and imports to be key elements in the analysis of competition within the fishing industry. These concepts are further discussed later in this report.

Conclusion on Constraint from Existing Competition

- 150 The proposed acquisition, and the resulting association of Sealord, Sanford, Amaltal and Talley's, is likely to lead to a significant aggregation of finfish quota which would fall just outside the usual safe harbours. However the reliability of such concentrated data must be assessed in the context of a product which is 90% exported. Further, competition in the harvesting market cannot be examined in isolation from competition in the downstream processing and wholesale markets, and constraints in those markets are likely to inhibit the extent to which any potential harvesting dominance could in fact be exploited.

Conditions of Entry

- 151 The Commission accepts that a business acquisition is unlikely to result in a dominant position in a market if the threat of new entrants acts as a significant constraint on behaviour in that market. An assessment of the nature and extent of that constraint represents a key element of the Commission's assessment of competition and market dominance.
- 152 Before the threat of new entry into the market can be evaluated, the conditions of entry have to be assessed and any barriers to entry need to be identified. If these barriers are high in aggregate, the threat of new entry will diminish.
- 153 The Commission's *Business Acquisitions Guidelines 1999* sets out a non-exhaustive list of barriers to entry. Following discussions with members of the fishing industry, the Commission has reviewed the relevant entry conditions below.

Individual Transferable Quota

- 154 In order to be able to harvest fish from New Zealand's Exclusive Economic Zone, sufficient Individual Transferable Quota (ITQ) must be obtained in order to cover the catch. This applies both to the target species (for example, hoki) and any species taken as by-catch (such as hake). By-catch is largely unavoidable because individual species cannot be targeted precisely. Failure to secure enough by-catch quota would result in the fisher having to pay the 'deemed value' of the by-catch to the Crown.
- 155 The total amount of ITQ (which is equivalent to the TACC) is fixed for each species and Quota Management Area, and can be either purchased or leased from other quota-holders.

- 156 ITQs are a unique and finite asset, designed to promote the efficient and sustainable harvesting of a 'common property' resource. ITQs, however, represent a significant cost of entering into the fish harvesting sector. For example, the Commission has been informed that one freezer trawler operating in the hoki fishery requires approximately 8,000 tonnes of hoki ITQ per annum. According to trade prices for the period October 1999-January 2000,¹⁰ the purchase of this amount of HOK1 quota would cost about \$18 million, while leasing the same quantity would cost \$2.3 million per annum. In addition, sufficient quantities of quota would be required to cover any by-catch of hake or other species. Recent trade and lease prices for hake have been in the ranges \$4,699-\$10,449 and \$429-\$688 per tonne respectively.
- 157 The Commission has also been informed that it is becoming increasingly difficult for incumbents, let alone new entrants, to purchase quota for the major finfish species such as hoki and orange roughy, as the markets for these ITQs have become illiquid. This would not necessarily rule out new entry, as quota can also be obtained on the lease market. Some concerns have been expressed about the fluidity of the quota leasing market for certain species. However, the Commission has obtained data on leasing transactions which suggests a reasonably fluid market for quota leases.¹¹
- 158 The Commission concludes that the existence of ITQs represents a significant barrier to entry to the fish harvesting market.

Harvesting Capacity

- 159 In addition to quota, a new entrant into the harvesting sector would have to obtain harvesting capacity. As with quota, this could be achieved through either purchasing or chartering an appropriate fishing vessel(s). The level of investment will depend very much on the particular fishery.
- 160 The main deepwater fisheries in New Zealand revolve around hoki and orange roughy. Hoki is taken by midwater trawling (300-600 metres), while orange roughy is a deep-sea trawl fishery (750-1200 metres).
- 161 The existing deep-sea catching capacity is dominated by large factory freezer trawlers. These vessels are up to 70 metres in length, have 40-50 crew, and may spend 6-7 weeks at sea per trip. The vessels are equipped with processing lines that snap-freeze semi- or fully-processed product, which is then landed for either on-processing or distribution. The capital cost of a fillet freezer trawler is in excess of \$20 million, while for a freezer trawler with semi-processing facilities (heading and gutting) costs upwards of \$15 million.
- 162 In the inshore fisheries, there is less onboard processing of catch than for the deepwater industry. Most inshore catch is taken by smaller vessels on trips of up to four days, with the catch often iced and then landed fresh at shore-based facilities for processing. Typical inshore methods are trawling and longlining, and vessels of these types cost between \$200,000 and \$2 million, depending on the size and age of the vessel.

¹⁰ *FishServe Quota Monitoring System, Feb 2000.*

¹¹ *Ibid.*

- 163 Industry sources have noted that there is currently a global surplus of fishing vessels. Used vessels are frequently available for purchase.
- 164 Harvesting capacity can also be chartered, avoiding the high capital cost of purchasing a vessel. Quota holders often charter other domestic or foreign vessels to catch some or all of their quota. For example, Amaltal undertakes some contract catching for other quota holders. Approximately 20 overseas charter vessels are currently operating in New Zealand.
- 165 The Commission concludes that while the capital costs associated with investment in deepwater harvesting capacity are significant, the ability to charter vessels, and the smaller investment outlays required in the inshore fisheries, significantly reduce the costs of accessing capacity in the fish harvesting market.

Constraints from Market Entry

- 166 In making this assessment, the Commission's approach is to consider whether the entry of new participants in response to the exercise of market power is likely, sufficient in extent, timely and sustainable. This is referred to as the '*lets*' test.

Likelihood and Sustainability of Entry

- 167 In order to be an effective constraint on incumbent market participants, entry into the fishing sector must be considered likely on commercial grounds. In addition, entry is likely only if there is likely to be a lasting economic incentive.
- 168 Since the introduction of the QMS in 1986, there has been considerable rationalisation in the harvesting sector of New Zealand's fishing industry. ITQs were initially allocated on the basis of catch histories, and as a result, fishing operations received a windfall gain in the form of valuable fishing quota. Industry sources have informed the Commission that many small operators sold their quota and exited the industry soon after the introduction of the QMS, while larger companies have consolidated their holdings of quota. One industry source suggested that the number of fishers in the industry has declined by 30% over the last five years.
- 169 The Commission considers the history of past market entry as an indicator of the likelihood of future entry. At the same time as quota holdings have become less diverse, there is little evidence of newcomers to the fishing industry. The main fishing companies were established well before the advent of the QMS.
- 170 The existence of ITQs as a necessary prerequisite to entry, owned by incumbents, is likely to distort any supply-side responses that could be expected in other markets. Typically, if a dominant company attempts to raise prices in its market, it can expect the price rise to draw new suppliers into the market. The existence of ITQs as a fisheries management tool blunts this supply-side response, as potential new entrants would have to obtain a share of a fixed total supply of quota.
- 171 For example, the TACC for the hoki fishery is currently 250,000 tonnes. A dominant firm, owning say 75% of the quota or 187,500 tonnes, could raise the price of landed

hoki, knowing that the aggregate response of competitors, both incumbent and potential new entrants, would be constrained by the remaining 62,500 tonnes of quota.

- 172 The above discussion of the barriers to entry and the history of entry into the fish harvesting sector suggest that potential entry on a scale that could provide an effective constraint on incumbent operators is unlikely.
- 173 On the basis of the analysis and the information received, the Commission has concluded that entry on a significant scale is neither likely nor sustainable.

Extent of Entry

- 174 If entry is to constrain an otherwise dominant firm, then entry must potentially be at a scale as to impact significantly on its behaviour.
- 175 The Commission has found that entry on a significant scale into deep-sea, and to a lesser extent inshore, harvesting is unlikely, and an examination of the recent trend of rationalisation and industry reorganisation confirms this.
- 176 The Commission concludes that it is unlikely that new entry could be achieved on a scale sufficiently large to effectively constrain the associated companies.

Timeliness of Entry

- 177 To effectively constrain the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent. The Commission has noted that the relevant time period has to be considered on a case-by-case basis.
- 178 There is nothing to suggest that there is a significant lead-in time for entry into the finfish harvesting sector. Once harvesting capacity, quota, and other regulatory approvals have been arranged, fishing can proceed. Notwithstanding the fore-mentioned concerns over the availability of quota for certain species, in which case entry may be delayed, the Commission considers that entry could be achieved in a timely manner.

Conclusion on Constraints from Market Entry

- 179 The need to hold sufficient ITQ to cover any harvesting represents a significant barrier for potential competitors, and may restrict the extent to which they can respond to any increase in landed fish prices. The high entry costs associated with purchasing both ITQ and deep-sea fishing vessels can to some extent be avoided through lease arrangements, which appear to be reasonably common. However, any entry would entail an equal-sized exit from the industry.
- 180 Having regard to the above factors, the Commission concludes that any new entry into the harvesting market is unlikely to be of a sufficient scale to act as an effective constraint on the associated companies in this market.

Conclusion on the Market for the Harvesting and Supply of Finfish in New Zealand

- 181 The proposed acquisition, and the resulting association of Sealord, Sanford, Amaltal and Talley's, is likely to lead to a significant aggregation of finfish quota. According to current information, the associated companies would own in the order of 56% of total finfish quota, and would hold 53% of the total. Given the disparate nature of rival ownership and holdings, this appears to fall outside the safe harbours. However, the Commission notes the potential unreliability of equating these shares with dominance concerns in New Zealand, given that 90% of seafood is exported and there appears to be available supply harvested by existing competitors which will act as a constraint to the associated companies. In addition, the Commission also notes that the associated companies are strongly export-oriented.
- 182 Further, competition in the harvesting market cannot be examined in isolation from competition in the processing and wholesale markets. The associated companies are vertically integrated and face a number of competitive constraints in downstream markets. In particular, the ability of medium-sized companies such as Independent, Vela, and United to divert exports to the domestic market represents a significant constraint on the ability of the associated companies to exert market power in the domestic processing and wholesale market. Furthermore, the ability to import seafood products provides an alternative source of product for domestic wholesalers.
- 183 The Commission's examination of the above factors has led it to conclude that competitive forces in downstream markets are likely to be sufficient to inhibit the extent to which any potential harvesting dominance could in fact be exploited.

The Market in New Zealand for the Processing and Wholesale Supply of Finfish in New Zealand ("The Processing Market")

Market Concentration

- 184 This market involves the receipt of finfish, its processing and wholesale to consumers in New Zealand.
- 185 Major participants in this market include the associated companies, Independent, United, Simunovich, Moana Pacific, Ngai Tahu Fisheries and Vela. In addition, there are a number of other processors of varying sizes.
- 186 As noted earlier, the fishing industry in New Zealand is export-orientated, with approximately 90% of all fish harvested sent to overseas buyers. While the Commission's focus is the likely effect of the proposal on the domestic market, the domestic market cannot be analysed in isolation from the export markets. Therefore, the Commission has, as a starting point, considered the overall processing capacity in New Zealand.
- 187 An estimate has been made of the total finfish processing capacity in New Zealand. Commission staff requested processing and supply revenue figures from the major processors, and further data from the New Zealand Seafood Industry Council (SeaFIC). This data, for both domestic and export markets, is listed in Table 8 below.

Table 8: Processing and Wholesale Supply of Finfish to Domestic and Export Markets

Supplier	Annual Revenue (NZ\$ million)	Estimated Market Share (%)
Sanford	[]	[]
Amaltel	[]	[]
Sealord	[]	[]
Talley's	[]	[]
Associated companies	[]	[]
Moana Pacific	[]	[]
Simunovich	[]	[]
United	[]	[]
Ngai Tahu	[]	[]
Independent	[]	[]
Other	[]	[]
Total	[]	100

- 188 If the current proposal were implemented, the associated companies would (on the basis of the above figures) account for approximately []% of the finfish output. Of the remaining suppliers the largest has a share of []% of the total output.
- 189 As noted earlier, the crucial figure is the amount of finfish which is processed and supplied to wholesalers by the associated companies in the domestic market. Industry estimates suggest that, out of a total estimated annual production of [], about [] is supplied to the domestic market, with the balance being exported. On the basis of information currently available to the Commission, the estimated domestic market share of the combined entity is represented in Table 9 below.

Table 9: Processing and Wholesale Supply to Domestic Market

Supplier	Estimated Annual Revenue (NZ\$ million)	Estimated Market Share (%)
Combined entity	[]	[]
Other domestic	[]	[]
Imports	[]	[]
Total	[]	100

- 190 On the basis of the above figures, the associated companies are estimated to supply approximately []% of domestic consumption. The balance of supplies is made up of imports and other domestic suppliers. A market share of []% places the associated companies within the Commission’s first “safe harbour” guideline (refer para 126), that is, having a market share less than in the order of 40%.
- 191 In considering its analysis of both the harvesting and processing markets, the Commission considers that this market share figure is of the greatest relevance, relating as it does directly to the supply of finfish in New Zealand.

Constraint from Existing Competition

- 192 The processing market is characterised by a large number of processors, ranging in size from small processing “sheds” catering for a small range of fish species, to large scale processing facilities that can produce a wide range of seafoods.
- 193 The larger fishing companies, including the applicant parties, are vertically integrated through harvesting, processing and supply. Smaller processors organise their operations in a number of ways. For example, they may own quota and fish it themselves, with leased quota “topping up” their requirements. Other processors will not own quota at all, but contract independent fishermen to supply them with fish.
- 194 The fish processed is then on-sold for further processing (eg. value-added products), exported, sold domestically through wholesalers and retail outlets, or supplied directly to the food service industry.
- 195 Based upon the information available, the Commission estimates that existing competition to the associated companies, from a wide range of domestic processors supplying the domestic market, accounts for approximately []% of this market. In such circumstances, it is unlikely that dominance concerns will arise, given the current competitive force of these processors.
- 196 A further constraint that would appear to alleviate dominance concerns in this market is the ability of competitors to divert export supplies back to the domestic market. A significant feature of this market is that approximately 90% of all the TACC is exported. This raises the issue of whether any market power can be exercised in the supply of fish to the domestic market, if export supply can readily be diverted to the domestic market.

- 197 The applicant has submitted that “any number of fishing entities could supply the entire New Zealand market”, and that fishing businesses will and do divert export product onto the domestic market if there is a price advantage in doing so.
- 198 [] advised that diversion of export supply was readily available, and could be done quickly if domestic market conditions were attractive. Other fish suppliers agreed that fish could be diverted to the domestic market. [] advised that this decision would be “price driven”. Presently, much of its output is exported, with a small quantity supplied to local wholesalers and retail stores.
- 199 [], similarly, advised that export product can be diverted to the domestic market if it was “commercially viable” to do so. Both [] and [] also considered that export supplies could be diverted to the domestic market, if the returns from the domestic market were more attractive.
- 200 Industry sources advised that the relative export volumes of the major processors (outside of the associated companies) allows them to continue export supply as well as divert product back to the domestic market (if the domestic market conditions are favourable).
- 201 The Commission understands that, typically, a harvester will “land” fish then supply that fish to the most attractive market. The decision to supply any particular purchaser is based upon a number of considerations, but primarily is influenced by the domestic price as opposed to the “spot” price at overseas markets (eg. the Sydney fish market).
- 202 Based upon the figures available to the Commission, existing competitors process approximately [] million of finfish per annum. As per Table 9 above, domestic consumption accounts for approximately [] million. Therefore, on the basis of these figures, the balance of processed finfish supplied by processors other than the associated companies would appear to comfortably satisfy domestic finfish demand. Indeed, the existing competitors process more than double the domestic consumption.
- 203 The Commission therefore views export sales by competitors as providing an ongoing competitive constraint. It appears unlikely that the associated companies could raise prices in the domestic market, without a competitive response by other suppliers. The ability of these other suppliers to divert exports affords them a ready response to any attempt to exercise market power by the associated companies. It is therefore likely that existing competitors provide a constraint upon the associated companies, with regard to the supply of finfish in New Zealand.
- 204 A further feature of this market that appears to provide a constraint upon any exercise of market power is the availability of imports. The Commission understands that, while the importation of frozen finfish is not significant “across the board”, it represents an important source for certain sectors of the food industry. For example, a number of industry sources referred to the recent importation of South American hake. While generally considered to be of a lower quality (by the industry) than locally caught finfish, it was widely purchased by fish and chip shops and processors of value-added products. For these purchasers, the price/quality mix was considered satisfactory, and afforded an alternative source of supply to domestically harvested finfish.

Potential Competition

- 205 A business acquisition is unlikely to result in any person acquiring or strengthening a dominant position in a market if behaviour in that market continues to be subject to significant constraints from the threat of market entry.

Likelihood and Sustainability of Entry

- 206 As described earlier, processing facilities differ in their operational bases. While some are vertically integrated, and own or lease quota at the harvesting level, other processors operate by purchasing raw material directly from fishermen and fishing companies. Consequently, their entry is not constrained by quota as is the case in the harvesting market.
- 207 The relatively large number of participants in this market suggests that entry conditions are not onerous. A number of processors (independent of the associated companies) supply the supermarkets and major wholesalers.

Extent of Entry

- 208 If entry is to constrain an otherwise dominant firm, then entry must potentially be at a scale and spread of operations as to impact significantly on its behaviour.
- 209 The range of operators in this market evidences the varying sizes at which entry can be effected.

Timeliness of Entry

- 210 To constrain effectively the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent. The Commission has said that the relevant time period has to be considered on a case-by-case basis.
- 211 The Commission understands that entry into this market requires a supply of raw material, and the necessary processing equipment. The processors in this market have advised that supply is sourced from a variety of suppliers, from around New Zealand.
- 212 Processing equipment is available new or second-hand, both domestically and internationally. Industry sources estimated that a reasonable sized processing facility would cost approximately \$1 million.
- 213 These factors are not considered onerous and, therefore, it is likely that entry could be effected within a reasonable timeframe.

Constraint from the Countervailing Power of Buyers

- 214 It has been estimated by the Fishing Industry Board that in the mid-1990s over 60% of wet fish marketed domestically was sold through supermarkets.¹² The general trend has been for supermarkets to increase their share at the expense of small, independent retailers, although speciality retail outlets have remained strong in Auckland.

¹² New Zealand Fishing Industry Board, *The New Zealand Seafood Industry: Economic Review, 1994-96*, Wellington: NZFIB, 1996, p. 10.

- 215 Supermarkets spoken to by the Commission have expressed concerns about the current high prices for fish supplies, the difficulty of getting sufficient quantities and species of a good quality on a regular basis, and the poor standard of service provided. They have expressed concerns that this situation may worsen should the proposed acquisition proceed. However, the applicants have argued that supermarkets sometimes have unreasonable expectations about wet fish availability and price, fuelled by comparisons with the margins they earn on other chilled food items, and by apparent consumer resistance to paying the relatively high prices. They argue that domestic fish prices essentially reflect export prices, and that availability is subject to weather variations and seasonal factors which are outside of the control of the fishers. The situation is also exacerbated by consumer unwillingness to try species of fish outside of the handful with which they are familiar, and which tend to be in more plentiful supply.
- 216 It is probably true to say that currently, supermarkets have little or no countervailing power to negotiate lower prices with fish suppliers. The export price provides the floor below which domestic prices will not fall. None of the larger suppliers would rationally sell fish domestically at prices less than those for which they could be sold overseas, after allowing for the extra costs associated with exporting. However, in the hypothetical situation where the combined entity was potentially able to exert market power in the domestic market by withholding supplies, and forcing up the price above the export price, one source of constraint would likely be the countervailing power of the supermarkets. Faced with a domestic price significantly higher than the export price, the supermarkets would have a strong incentive to ‘shop around’ between the various suppliers outside of the combined entity to secure a better deal, and those suppliers would have an incentive to undercut the high price in order to secure the volume of sales made available by a supermarket contract. In this way, the Commission anticipates that the countervailing power of the supermarkets would help to undermine any attempts by the combined entity to exert market power.

Conclusion on the Processing Market in New Zealand

- 217 Based on the information available, the associated companies are likely to hold a market share of approximately []%. A market share of under 40% places the associated companies within the first of the Commission’s “safe harbours”, and indicates that there are unlikely to be dominance concerns.
- 218 Further, it is likely that the associated companies will continue to face competition from existing processors supplying the domestic market. The Commission estimates that these competitors, representing a wide range of processors, make up to []% of this market. The current competitive constraint effected by these competitors is expected to continue should this proposal be implemented.
- 219 In addition, there exists the ability of harvesters to divert export supplies to the domestic market, if it is commercially viable to do so. In these circumstances, under such conditions, it is unlikely that the associated companies could exert any degree of market power in regards to the supply of finfish in New Zealand. Further, the availability of imports, while not a notable current feature of the market in New Zealand, appears to offer an alternative supply source for certain buyers, and may be considered as representing a further constraint upon the associated companies.
- 220 The Commission concludes, therefore, that the associated companies would not, or would not be likely to, acquire or strengthen a dominant position in the processing market in New Zealand.

The Market for the Processing and Wholesale Supply of Value-Added Finfish Products in New Zealand (“The Value-Added Market”)

Market Concentration

- 221 The associated companies are the major producers of value-added seafood products in New Zealand. Sealord produces the “Sealord” and “Captain Choice” branded products. Outside of the associated companies, Independent is a major producer, supplying products under the “Sea Casket” and “Independent” brands.
- 222 The balance of sales in this market is made up of a number of value-added processors, supplying the food service industry (fish and chip shops, restaurant trade, etc), and supermarkets.
- 223 The applicant provided AC Neilson data for frozen processed fish products, sold through the supermarket retail chains in New Zealand. It is noted that the data does not represent all sales of processed fish products, as sales through dairies and direct to the food service industry are not included. However, the Commission understands that supermarkets account for a large proportion of the sales of processed fish products. Given the time available, the Commission considers that this information provides a fair estimation of overall market share. This data is reproduced in table 10 below.

Table 10: Value-Added Fish Product Sales through Supermarkets

Suppliers	Estimated Market Share
Sealord	[]%
Independent	[]%
Other	[]%
Total	100%

- 224 The above market share figures place the associated companies within the Commission’s “safe harbour” guidelines.

Constraint from Existing Competition

- 225 As evidenced by the above figures, Independent currently provide effective competition to Sealord in this market. This is expected to continue should the current proposal be implemented.
- 226 There are other smaller processors of value-added products, such as Food Partners, Polaris, and Franklin Foods. These processors purchase fish from domestic suppliers, and manufacture value-added products under their own label, or under contract for another party. Typically, the sourcing of raw materials for manufacture is not subject to any one supplier, and manufacturers are able to buy particular species as and when it is available.
- 227 Food Partners currently supplies its own branded products, “Leader”, through the food service and supermarket chains. []]. Polaris manufactures

value-added fish products and markets these under its own brand name “Polaris”. Franklin Foods manufactures products under the “Andrew Corbett” brand.

- 228 In addition to the presence of other branded fish products, supermarkets and other industry sources considered that value-added fish products compete with other value-added frozen products, such as crumbed chicken portions. These products are all displayed in the frozen foods selection of a supermarket, and consumers, to some degree, appear to treat these products as substitutable. As stated earlier, the Commission has chosen to adopt a narrower value-added “fish” product market. However, it appears likely that these products will face some constraint from other value-added meat and protein products.

Potential Competition

- 229 Entry into this market requires a supply of raw material, and the necessary processing equipment.
- 230 Processors in this market source fish supplies from any number of suppliers. Generally, the main species in frozen breaded products is hoki and southern blue whiting, although the Commission understands that other species can be, and are, used. Substitutable species include trevally and warehou.
- 231 Recently, there has been an importation of South American hoki into New Zealand. This hoki, generally regarded by many industry sources as being of slightly inferior quality to the locally-caught hoki, is used by the food service, principally fish and chip shops, and in value-added processed fish products. [] advised that it uses South American hoki in its value-added products, due to the high price of locally caught hoki.
- 232 The cost of entry into the value-added market appears moderate. The Commission understands that the requisite second-hand machinery is available for approximately \$200,000 (to produce a particular line or product). Set-up costs for new equipment can be up to \$2 million.
- 233 The Commission has been advised that there is a ready market worldwide for secondhand processing equipment, and that it is readily obtainable through brokers specialising in such equipment.
- 234 In this case the Commission considers that, given the above considerations, that market entry is likely to be both likely and sustainable, to be of sufficient extent, and to be effected in a timely manner. That is, the threat of market entry is likely to satisfy the “*Lets*” test, and provide a sufficient constraint on the exercise of market power.

Conclusion on the Value-Added Market in New Zealand

- 235 Based upon the information available, the market share figures in this market appear to fall within the Commission’s “safe harbours”. Further, competition from existing operators, particularly Independent, appears to be reasonably strong. In addition, barriers to entry appear moderately low.
- 236 The Commission concludes, therefore, that the associated parties would not, or would not be likely to, acquire or strengthen a dominant position in the value-added market in New Zealand.

The Market for the Cultivation and Supply of Greenshell Mussels New Zealand

Market Concentration

- 237 Greenshell mussels are farmed using a series of buoys and ropes. There are about 605 farms in New Zealand waters with about 478 farms being located in the sheltered waters of the Marlborough Sounds. Other areas that produce mussels include Hauraki, Nelson and Southland.
- 238 Ownership of mussel farms is relatively fragmented, with 200 individual owners owning the total production capacity. Sealord own 32 mussel farms, Sanford 66, and Talley's 16. The Commission obtained production figures from the associated parties to the proposal, as well as several other major producers of greenshell mussels. The figures obtained by the Commission are shown in Table 11 below.

Table 11
Market Shares of the Market for the Cultivation and Supply of
Greenshell Mussels in New Zealand

Supplier	Production (GWT)	Market Share (%)
Sealord	[]	[]
Sanford	[]	[]
Talley's	[]	[]
Associated Companies	[]	[]
Pacifica	[]	[]
Marlborough Seafoods	[]	[]
Nelson Ranger	[]	[]
United	[]	[]
Other	[]	[]
Total	[]	100%

- 239 The associated companies would have a market share of [] with the next largest competitor having a market share of []. The merged entity's market share would be within the Commission's 'safe harbour' guidelines, which indicates no dominance. However a competition analysis will be conducted to ensure that dominance will not be acquired.

Existing Competition

- 240 As Table 11 shows, the production of greenshell mussels is relatively fragmented and this merger will result in some consolidation in this market. The associated companies would have a market share of [] with Pacifica Seafoods being the next largest competitor with a market share of []. There are three other smaller competitors with a combined market share of []. The remaining production is highly fragmented.
- 241 The mussel industry is maturing, and companies involved in the industry are becoming larger and vertically integrating their operations. This ensures a secure supply of the product, with most large producers supplying a large proportion of their production to

their own processing operations. The balance of their supply, will be from independent producers who account for about [] of total production.

- 242 The associated companies would not be in a position to exercise market power at this functional level of the market because of their vertically integrated structure, they are net purchasers of mussels. They would rely heavily on supply from independent producers to satisfy their demand.

Potential Competition

- 243 A business acquisition is unlikely to result in the acquisition or strengthening of dominance if there is a credible threat of market entry. Potential competition can act as a constraint on market power, and so an examination of the nature and extent of this constraint is part of the Commission's assessment of competition.
- 244 Entry conditions, including the nature and height of any entry barriers, must be considered before the threat of new entry, which might constrain the conduct of a merged entity, can be evaluated.

Regulatory Compliance

- 245 Mussel farming requires the allocation of public coastal space for commercial purposes, this is a critical input. In the past the process for allocating the coastal resource has been through leases, Ministry of Fisheries licences and resource consents. All consents are now issued under the Resource Management Act 1991, and are for a limited period. The maximum term under the Act is 35 years and the renewal of a consent is not automatic as the environmental impact of the activity is reviewed.
- 246 The coastal space areas where mussel farming is permitted are becoming more tightly controlled by local body authorities, which has the effect of reducing the ability of existing farms to increase production, and the ability of new entrants to enter the market and increasing output. However in Marlborough, the largest producing area, a Department of Conservation moratorium on the issue of new licences was lifted in July 1999. Since that time the Marlborough District Council has received 320 applications relating to the increase of production capacity.
- 247 This regulatory environment has created some advantage for incumbent firms and a regulatory barrier to entering the market for potential entrants. However it is the Commission's view that these barriers are not onerous, and there is a strong likelihood that productive capacity will be increased in the future. Eventually, as the productive space is utilised, the rising cost of acquiring rights to this space could limit supply.¹³

Capital Costs of Entry

- 248 The capital investment required to enter this market are not large with an investment of about [] required to set up a small farm. Many of the activities of mussel farms can be outsourced to contractors, which makes smaller farms more economical.

¹³ Supra note 6, at p67.

The “Lets” Test

249 The “lets” test will now be applied to the market under analysis.

Likelihood of Entry

250 The greenshell mussel is product unique to New Zealand and is currently subject to increased demand in overseas markets. These conditions have resulted in an increase in the price for the product and improved industry profitability.

251 New entry into this market would require compliance with Ministry of Fishery regulations and the Resource Management Act. Since the lifting of a Department of Conservation imposed two year moratorium, the Marlborough District Council have received 320 applications for the issuance of new licences. Successful applications require a resource consent and this will be determined by the nature of the application. Once this has been achieved it is the Commission’s view that entry into this market is likely because of the improved profitability and the existence of space available for development.

Extent of Entry

252 The addition of extra production capacity could be of a sufficient scale to constrain a dominant firm if it attempted to exercise market power.

Timeliness of Entry

253 The obtaining of the necessary resource consents is a time consuming process, especially if the application is prolonged by the appeal process. The Commission understands that in Marlborough, the major production region, there is a current backlog of applications. This is likely to result in a processing period of up to two years, which accords with the Commission’s timeframe for considering entry. However, the Commission understands that a number of early applications have been, and are currently being, processed, which will result in new entrants entering this market within the stated timeframe. Entry in the future is likely to be subject to some delay, however it is also likely that entry can still be effected within two years.

Sustainability of Entry

254 Profitability in the industry has improved due to the increasing demand for the greenshell mussel. It is the Commission’s view that although there will be price fluctuations, entry into this could be sustainable due to the positive long-term outlook for the industry.

Conclusion on the “Lets” Test

255 Entry into this market is likely and could be effected in a timely and sustainable manner which would offer constraint to the exercise of market power.

The Countervailing Power of Buyers and Suppliers

256 The operations of larger companies in this industry are internal through vertical integration. Notwithstanding this fact, these companies still need to purchase some of their supply of mussels from independent farmers. The effect of this vertical integration results in the merged entity being the net purchasers, with a low level of countervailing power.

Conclusion on the Market for the Cultivation and Supply of Greenshell Mussels in New Zealand

257 The associated companies would have a market share of [] with the next largest competitor having a market share of []. The remaining [] of production is highly fragmented. These levels of market share place the merged entity within the Commission's 'safe harbour' guidelines. The merged entity through its vertically integrated structure, are net purchasers of mussels, therefore it is not in their economic interests to raise prices.

258 The main barrier to entering this market is the regulatory barrier of obtaining a fishing permit and obtaining the necessary resource consents. However it is the Commission's view that these barriers are not onerous and the threat of new entry would constrain the merged entity if it attempted to exercise market power by raising prices.

259 On the basis of the matters discussed above, the Commission concludes that NZSI and associated parties are not currently dominant in the market for the harvesting of mussels for processing, and would not be likely to acquire a dominant position in this market as a result of the acquisition.

The Market for the Harvesting and Supply of Scallops in New Zealand

Market Concentration

260 The harvesting of scallops is subject to the QMS. The TACC for the 1999/00 fishing year was set at 826 tonnes.¹⁴ In the 1997/98 fishing year the TACC was 909 tonnes of which 357 tonnes were harvested.

261 The market share of quota owned and quota held for the scallop fishery is shown in Table 12.¹⁵

¹⁴ meatweight tonnes. To convert to greenweight tonnes (GWT) the conversion ratio of 7 to 1 is used.

¹⁵ Quota 'owned' means ownership of the property right, quota 'held' means quota owned and fished or quota leased.

Table 12
Production and Supply of Scallops in New Zealand

Quota Holder	Quota Owned (tonnes)	Production Share (%)	Quota Held (Tonnes)	Production Share (%)
Talley's Fisheries	249.145	30%	249.145	30%
Sanfords	18.579	2.2%	-	-
Associated companies	267.724	32.2%	249.145	30%
Guards Sea Holdings	34.745	4.2%	34.745	4.2%
McDonald & Brown	28.472	3.5%	28.472	3.5%
Rongo Marie	27.164	3.2%	27.164	3.2%
Ngati Apa	21.474	2.6%	21.474	2.6%
TOWFC	21.199	2.5%	-	-
Ngati Koata	20.509	2.5%	20.509	2.5%
Ngati Kuia	20.509	2.5%	20.509	2.5%
Ngati Rarua Iwi	20.509	2.5%	20.509	2.5%
Ngati Tama	20.509	2.5%	20.509	2.5%
Te Atiawa	20.509	2.5%	20.509	2.5%
Ika Toa	-	-	20.509	2.5%
Other	322.677	39%	341.946	41.3%
Total	826	100%	826	100%

Source: Ministry of Fisheries.

262 Table 12 shows that the associated companies would have a market share of 32.2% in the quota owned category and 30% in the quota held category. The next largest competitor would have a market share of 4.2%. These levels of market shares are inside the Commission's 'safe harbour' guidelines and as such do not indicate dominance. However a competition analysis will be conducted to ensure that dominance will not be acquired.

Constraint from Existing Competition

263 Quota holdings by competitors are highly fragmented in this fishery, with the largest competitor to the merged entity having 4.2% of the quota holdings. The remaining quota is held or owned by a large number of entities each owning or holding a relatively small amount.

264 The effect of the QMS is to fix the domestic supply of scallops. If the associated companies were to attempt to exercise market power by increasing the price, the existing competitors would be limited in their ability to constrain the merged entity by expanding output.

- 265 However, presently a proportion of the scallop catch is exported. In 1999 there were 521.4 tonnes of scallops exported,¹⁶ this represents about 11% of the total catch. Some of this quantity is exported by existing competitors who could divert export supply to the domestic market if the associated companies attempted to raise prices above the competitive level.
- 266 Further, scallops are imported, with 220 tonnes being imported in 1999.¹⁷ Evidence from the market suggests that the imported product competes with the domestic product and therefore offers competitive constraint to the associated companies if they were to increase the price of New Zealand scallops.

Potential Competition

- 267 The inherent characteristics of the QMS are such that the total supply of scallops for a fishing year is fixed, with total supply being increased or decreased each year based on scientific factors. The quantity of scallops any one entity can harvest is determined by their quota holding. Quota holdings can be increased through purchasing or leasing quota. This requirement of quota holding creates a large barrier to entering this market.
- 268 Between October 1986 and January 2000 there were 1090.197 tonnes of quota traded, or 1.31 times of the current TACC. There were 179 transactions. In the same period, there were 3,938.507 tonnes of quota leased or 4.76 times of the current TACC. There were 966 leasing transactions within this period. These figures show that ownership of quota is relatively stable, however there is an active leasing market with 966 leasing transactions within the period.
- 269 Recently, during the period October 1999 to January 2000 14.977 tonnes of quota were traded which related to 4 transactions. The average price per tonne for these transactions was \$51,814. Whilst in the same period 29.448 tonnes of quota were leased which related to 14 transactions.
- 270 These figures show that the purchasing of quota is capital intensive. However the most important barrier to entering the market is access to quota and the figures show that such access is not easily obtained.

The “*Lets*” Test

Likelihood of entry

- 271 The harvesting of scallops is governed by the quota system so a new entrant would have to either purchase or lease quota to enter the market. Currently, the market for the purchase of scallop quota appears illiquid, although the lease market is quite active, suggesting opportunities for entry in the short-term through leasing quota.

¹⁶ <http://www.seafood.co.nz/Export_Stats/table_99totals.htm>

¹⁷ Data provided by Statistics New Zealand.

Extent

- 272 It is unlikely that a new entrant could enter the market to the extent that it could provide any additional constraint on a dominant firm. Given the new entrant would have to either purchase or lease quota, this merely equates to a transfer of market share, leaving the new firm in no stronger a position than the old one. It is considered, therefore, that the extent aspect of the test is not satisfied.

Timeliness

- 273 The main entry conditions are obtaining quota and purchasing capital equipment. Provided the potential entrant is prepared to meet the necessary investment, entry is possible within a reasonably short time-frame.

Sustainability

- 274 The scallop industry in New Zealand makes up a small part of what is a large world market. It is reasonable to assume, therefore, that new entrants could expect their harvest to be in demand.
- 275 The Commission recognises that in all industries a business must maintain some degree of efficiencies to guarantee survival and the shellfish industry is no different. The characteristics of the quota system, however, has created a degree of security to quota holders. Quota holders are not threatened by new entrants flooding the market and depressing prices. Instead, incumbents are almost guaranteed a good price for their shellfish. Similarly, new entrants know that should they obtain quota and enter the market, the price is likely to be maintained at its current level, ensuring long-term profitability.

Conclusion on the “Lets” test

- 276 The Commission concludes that given a new entrant could not enter the market to the extent required to constraint a dominant firm, and so the “lets” test is not satisfied.

The Countervailing Power of Buyers and Suppliers

- 277 The associated companies have vertically integrated structures. In this market, Sealord, Sanford and Talley are involved in quota ownership or quota leasing, and the processing and wholesale supply of scallops. The associated companies would be net purchasers of scallops, relying on independent supply. There are other smaller purchasers of scallops. However, in these circumstances, they are unlikely to hold any significant degree of countervailing power.

Conclusion on the Market for the Harvesting and Supply of Scallops in New Zealand

- 278 The associated companies would have a market share of 30% of quota owned and 32.2% of quota held. This level of market share is inside the Commission’s ‘safe harbour’ guidelines. The remaining ownership is very fragmented with a large number of entities owning a small amount of quota. If the associated companies attempted to

exercise market power it is the Commission's view that they would be constrained by the behaviour of existing competitors diverting export supply to the domestic market. Scallops are also imported, which would also constrain the associated companies through increased supply to the domestic market.

- 279 The barriers to entering the market are high because the total annual supply is fixed and the ability to harvest scallops is determined by the amount of quota held. Quota is traded relatively infrequently and requires a large capital investment to obtain a significant holding.
- 280 The Commission's examination of these factors has led it to conclude that the associated companies would not, or would not be likely to, acquire or strengthen a dominant position in this market as a result of the proposed acquisition.

The Market for the Harvesting and Supply of Dredge Oysters in New Zealand

Market Concentration

- 281 The harvesting of dredge oysters is subject to the QMS. The TACC for the 1998/99 fishing year was 505 tonnes for the QMA OYS7 and 14.950 (million oysters) for the QMA OYU5. The merged entity would have 38% of quota held and 37% of quota owned for QMA OYS7. The associated companies would have a very small proportion of the quota held for QMA OYU5. The level of quota held and quota owned is outlined below in Table 13.

Table 13
Quota Holdings of Dredge Oysters

Supplier	Quota Owned¹⁸ (Tonnes)	Production Share (%)	Quota Held (Tonnes)	Production Share (%)
Talley's	186.323	9%	165.323	8%
Sealord	-	-	25.25	1%
Associated companies	186.323	9%	190.573	9%
TOWFC	305.102	15%	-	-
ITQ Management Limited	265.306	13%	-	-
Otakou Fisheries	132.653	6.5%	285.204	14%
Pacifica Seafoods	-	-	265.306	13%
Ngai Tahu	-	-	149.591	7%
Other	1133.616	56%	1,132.326	57%
Total	2023	100%	2,023	100%

Source: Ministry of Fisheries

¹⁸ The OYS7 TACC is 505 tonnes. However, the OYU5 TACC is identified by a catch limit, the figure for the 1999/00 year being 14.950 million oysters. There are 23 quotas for this fishery, with 1 quota relating to 650,000 oysters. Using a conversion rate supplied by the industry, 800 oysters = 81.25kg, 14.950 million oysters weighs approximately 1,518 tonnes. The total TACC for both fisheries is therefore 2,023 tonnes. Market shares were calculated using this methodology.

282 The associated companies would have a market share of 9% of total quota owned and 9% of total quota held in both of these QMA fisheries. The largest quota holder of oysters is the TOWFC with 15%. This quota is leased to Iwi groups on an annual basis. Otakou Fisheries is the largest competitor with 6.5% of owned and 14% of quota held. Pacifica Seafoods has 13% of quota held. The distribution of the remaining ownership is highly fragmented, with a large number of holders each owning or holding a small amount. These levels of market shares are well within the Commission's 'safe harbour' guidelines and do not indicate dominance. However a competition analysis will be conducted to ensure that dominance is not acquired.

Constraint from Existing Competition

283 Presently, 100% of the production of dredge oysters is consumed domestically; no dredge oysters are exported. The effect of the QMS is to fix the supply of dredge oysters onto the domestic market. If the associated companies attempted to exercise market power by reducing supply to the domestic market therefore increasing price, their low level of market share suggests that they would be constrained by the behaviour of existing competitors.

284 There is also a quantity of dredge oysters imported, the predominant form being frozen oyster meat as opposed to fresh oysters. In the 1999 year 58,950 dozen frozen oysters were imported,¹⁹ this represents a small proportion of the total supply to the domestic market. However, an increased supply of imported oysters could act as a constraint on the behaviour of the associated companies.

Potential Competition

285 As discussed above in the analysis on the scallop market, quota is required to enter this market and this creates a large barrier to entry. Quota can either be purchased or leased.

286 For the period October 1986 to January 2000, there were 19 trades of quota in the OYU5 fishery relating to a total tonnage of 5,853.322. This figure illustrates that the current catch limit has been traded 3.8 times in the 14 year period. During the same period, there were 60 trades of quota in the OYS7 fishery relating to 600.534 tonnes. This figure shows that the current catch limit has been traded about 1.18 times which is not large when considering the time period.²⁰ These facts illustrate that quota is infrequently traded.

287 During the same period, there were 43 lease transactions in the OYU5 fishery, relating to 21,948.683 tonnes. The current catch limit has been leased about 14 times. In the OYS7 fishery there were 159 transaction relating to 1,623.997 tonnes. The current TACC has been leased 3.2 times which is not large when considering the time period.

288 For the most recent period, October 1999 to January 2000, there has been one lease transaction in OYU5 relating to 305.102 tonnes, and 27 lease transactions in OYS7 relating to 456.690 tonnes. These figures show that there is some liquidity in the

¹⁹ Data supplied by Statistics New Zealand.

²⁰ Commercial Fisheries Services Limited, *Quota Monitoring System*, February 2000, 33.

leasing market with a significant proportion of the leasing transactions relating to large amounts.²¹

- 289 The ability to access quota is the most important factor for any potential entrant into this market. The above analysis illustrates that there is some liquidity in the trading and leasing of quota. However quota is generally leased for short periods, over the course of a fishing season. This would explain the high level of leasing activity.
- 290 The investment in quota represents a large capital cost which would impose a barrier to entering the market for smaller fishing operations. However a larger fishing operator would have the financial resources to purchase quota, the issue such an entrant would face would be the availability of quota to purchase.

The “Lets” Test

- 291 The harvesting of oysters is similar in many aspects to that of scallops. For this reason, the respective lets tests are analogous in places.

Likelihood of Entry

- 292 The harvesting of oysters is governed by the quota system so a new entrant would have to either purchase or lease quota to enter the market. Currently, the market for the purchase of oyster quota appears fairly illiquid, although the lease market is active, suggesting opportunities for short-term entry through leasing quota.

Extent

- 293 It is unlikely that a new entrant could enter the market to the extent that it could provide any additional constraint on a dominant firm. Given the new entrant would have to either purchase or lease quota, this merely equates to a transfer of market share, leaving the new firm in no stronger a position than the old one. It is considered, therefore, that the extent aspect of the test is not satisfied.

Timeliness

- 294 The main barriers to entry are obtaining quota and purchasing capital equipment. Provided the potential entrant is prepared to meet the necessary investment, entry is possible within a reasonably short time-frame.

Sustainability

- 295 Oysters are extremely popular in New Zealand and typically sell out despite retailing for over \$1 per oyster. It is assumed, therefore, that a firm harvesting oysters and supplying to wholesalers would have great demand for their produce.

²¹ Ibid at 38.

- 296 As per scallops, the quota system has resulted in maintaining prices by restricting supply. Current and prospective quota holders can be confident that current prices will be maintained, ensuring long-term profitability.

Conclusion on the “Lets” test

- 297 The Commission concludes that given a new entrant could not enter the market to the extent required to constrain a dominant firm, the *lets* test is not satisfied.

Countervailing Power of Buyers and Suppliers

- 298 Generally the sale of harvested dredge oysters to processors is internal, most of the large operations are vertically integrated therefore creating a neutral effect for the countervailing power of buyers. The associated companies are net purchasers of dredge oysters.

Conclusion on Market for the Harvesting and Supply of Dredge Oysters in New Zealand

- 299 The associated companies would have a market share well inside the Commission’s ‘safe harbour’ guidelines. This level of market share does not indicate dominance. The merged entity could be constrained by the behaviour of existing competitors and through imported oysters. The barriers to entering the market are high; to harvest oysters quota is needed which requires a large capital investment, and it is also difficult to purchase. It is unlikely that the associated companies could be constrained by the threat of new entrants.
- 300 The Commission’s examination of these factors has led it to conclude that the associated companies would not, or would not be likely to, acquire or strengthen a dominant position in this market as a result of the proposed acquisition.

The Market for the Processing and Wholesale Supply of Shellfish in New Zealand

Market Concentration

- 301 The processing of one species of shellfish is substitutable for another species of shellfish (refer paragraphs 115-118). If a processor of one species wanted to expand into the processing of another species of shellfish, they could do so in a timely manner without significant investment in sunk costs. The Commission has obtained from market participants, processing figures to enable the calculation of market shares. The figures for the total processing and wholesale supply of shellfish are outlined below in Table 14. The figures for the processing and wholesale supply of shellfish in New Zealand are outlined in Table 15.

Table 14
The Estimated Market Shares for the Processing and Wholesale Supply of Shellfish

Processor	Mussels (GWT)	Scallops (GWT)	Oysters (GWT)	Total (GWT)	Market share (%)
Sealord	[]	[]	[]	[]	[]
Talleys	[]	[]	[]	[]	[]
Sanfords	[]	[]	[]	[]	[]
Associated companies	[]	[]	[]	[]	[]
Pacifica Seafood	[]	[]	[]	[]	[]
Marlborough Seafoods	[]	[]	[]	[]	[]
Nelson Ranger	[]	[]	[]	[]	[]
Barnes Oysters	[]	[]	[]	[]	[]
Other	[]	[]	[]	[]	[]
Total	[]	[]	[]	[]	[]

Table 15
**The Estimated Market Share of the Market for the Processing and Wholesale Supply of
Shellfish in New Zealand**

Processor	Mussels (GWT)	Scallops (GWT)	Oysters (GWT)	Total (GWT)	Market share (%)
Sealord	[]	[]	[]	[]	[]
Talleys	[]	[]	[]	[]	[]
Sanfords	[]	[]	[]	[]	[]
Associated companies	[]	[]	[]	[]	[]
Pacifica Seafood	[]	[]	[]	[]	[]
Marlborough Seafoods	[]	[]	[]	[]	[]
Nelson Ranger	[]	[]	[]	[]	[]
Barnes Oysters	[]	[]	[]	[]	[]
Other	[]	[]	[]	[]	[]
Total	[]	[]	[]	[]	100%

- 302 The associated companies would have a market share of [] and the next largest competitors having market shares of [] and []. These levels of market shares are outside the Commission's 'safe harbour' levels and are an indicator of possible dominance. A competition analysis will be conducted to examine whether dominance could be acquired.

Constraint from Existing Competition

- 303 The next largest competitors are Barnes Oysters an oyster supplier, and Pacifica Seafoods and Marlborough Seafoods. These companies are both vertically integrated businesses who purchase a quantity of their supply from independent mussel farmers. If the associated companies attempted to exercise market power by reducing the price paid to independent suppliers, existing competitors could utilize existing capacity or expand capacity to process an increased supply. The Commission understands that over []% of mussel production is exported. If the merged entity increased the wholesale price of mussels to the domestic market, existing competitors could increase supply to the market by diverting export supply therefore constraining the behaviour of the associated companies.
- 304 The associated companies would be large processors and wholesale suppliers of scallops. If they attempted to exercise market power by reducing the price paid to suppliers below the market price, existing competitors could expand their capacity to process or diversify into processing the species in a timely manner and without incurring substantial sunk costs. If the associated companies increased the wholesale price above the market price, existing competitors could increase supply to the domestic market by diverting exported product or by increasing the supply of imported product.
- 305 The associated companies would also be a large processor and wholesale supplier of dredge oysters. If they attempted to exercise market power by reducing the price paid to suppliers below the market price, existing competitors could expand processing capacity or diversify into processing the species in a timely manner without incurring a large sunk cost. If the associated companies increased the wholesale price of processed oysters to the domestic market, other processors could not increase their domestic supply because their supply is fixed. It may not be economical to do this if fixed costs are high and this behaviour increases average costs. The harvesting period is also seasonal. The behaviour could be constrained by the increased importation of frozen oyster meat.

Constraint from Potential Competition

- 306 The resources required to successfully enter this market are a suitable plant that complies with the various regulations, and various stainless steel equipment used in the processing operation. A larger investment in equipment is required for mussel processing because of the characteristics of the product. There is a second-hand market for this type of equipment.
- 307 An investment in mussel processing equipment would involve a capital cost of between \$5m and \$10m to enable production to reach an efficient scale.

- 308 The processing of oysters and scallops is seasonal and therefore some capacity is partly utilized. The processing of mussels by the bigger companies is normally done on an annual basis ensuring better utilization of capacity.
- 309 Access to a secure supply of product would impose a barrier to entering the market for a new entrant, particularly for scallops and oysters. This is one of the reasons why there is a high level of vertical integration in the industry. A new entrant could obtain a supply of mussels by negotiating with existing suppliers to supply at a price premium. A new entrant could also obtain a supply of scallops or oysters if the merged entity attempted to exercise market power. However, excluding those conditions it would be difficult for a new entrant to access supply.

The “Lets” Test

Likelihood of Entry

- 310 The barriers to entering this market are not onerous, this is evidenced by the relative large number of competitors in the market. As the demand for shellfish increases, current excess capacity will be utilised as supply increases, and further capital investment will be required in this market. Entry is likely in this market.

Extent of Entry

- 311 Entry into this market could be made at a level that would achieve efficiencies and would offer significant constraint to the exercise of market power.

Timeliness of Entry

- 312 Entry could be made in a timely manner. If the entrant was investing in new plant and equipment, entry could be effected within a period of six months to one year.

Sustainability of Entry

- 313 With growth in the cultivation and supply market, particularly in the supply of mussels, and as existing excess capacity was utilised, this would create a condition where new entry would be sustainable.

Conclusion on the “Lets” Test

- 314 On the basis of the above analysis, entry into this market is likely, and this threat of entry would constrain the exercise of market power.

The Countervailing Power of Buyers and Suppliers

- 315 Independent suppliers are generally fragmented but they do have the ability to switch purchasers and exercise a level of constraint. Buyers, particularly supermarket purchasers, are concentrated and do exercise a level of countervailing power by their ability to switch suppliers.

Conclusion on the Market for the Processing and Wholesale Supply of Shellfish in New Zealand

- 316 The merged entity would have a market share of [], whilst the next largest competitor would have a market share of []. These levels of market share are outside the Commission's 'safe harbour' guidelines.
- 317 Notwithstanding these market shares, potential supply sources for shellfish are only limited with regard to dredge oysters (see para 299). Mussels and scallops are available through new entry and imports. However, with regard to dredge oysters, the associated companies have a production share of []% (see Table 13), alleviating dominance concerns.
- 318 If the associated companies attempted to exercise market power they would be constrained by the behaviour of existing competitors, although this level of constraint would be limited for the processing of oysters.
- 319 The main barriers to entering the market would be the access to supply of an input particularly for scallops and oysters, because of the nature of the QMS. However it is the Commission's view that if market power were exercised by lowering the price paid for the input, access to supply could be obtained.
- 320 The Commission's examination of these factors has led it to conclude that the associated companies would not, or would not be likely to, acquire or strengthen a dominant position in this market as a result of the proposed acquisition.

OVERALL CONCLUSION

- 321 The Commission has considered the likely impact of the proposal in the following markets:
- the market for the harvesting and supply of finfish in New Zealand (the 'harvesting market');
 - the market in New Zealand for the processing and wholesale supply to domestic and export markets of finfish in fresh and frozen form (the 'processing market');
 - the market in New Zealand for the processing and wholesale supply of frozen, branded, sea-food products (the 'value-added market');
 - the cultivation and supply of greenshell mussels in New Zealand;
 - the harvesting and supply of scallops in New Zealand;
 - the harvesting and supply of dredge oysters in New Zealand; and
 - the processing and wholesale supply of shellfish in New Zealand.
- 322 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any of the markets listed in paragraph 321.

- 323 The Commission has made its determination based on market share and fishing quota held by the applicant and its associated companies as at the date of the clearance. In reaching these conclusions the Commission has relied on the provisions of the Commerce Act 1986 and not the regimes established under the various Fishing Acts for the acquisition and aggregation of quota. If there were to be further acquisition of quota by either purchase or lease in the future by the applicant or its associated companies, then that acquisition is subject to section 47 of the Commerce Act 1986.

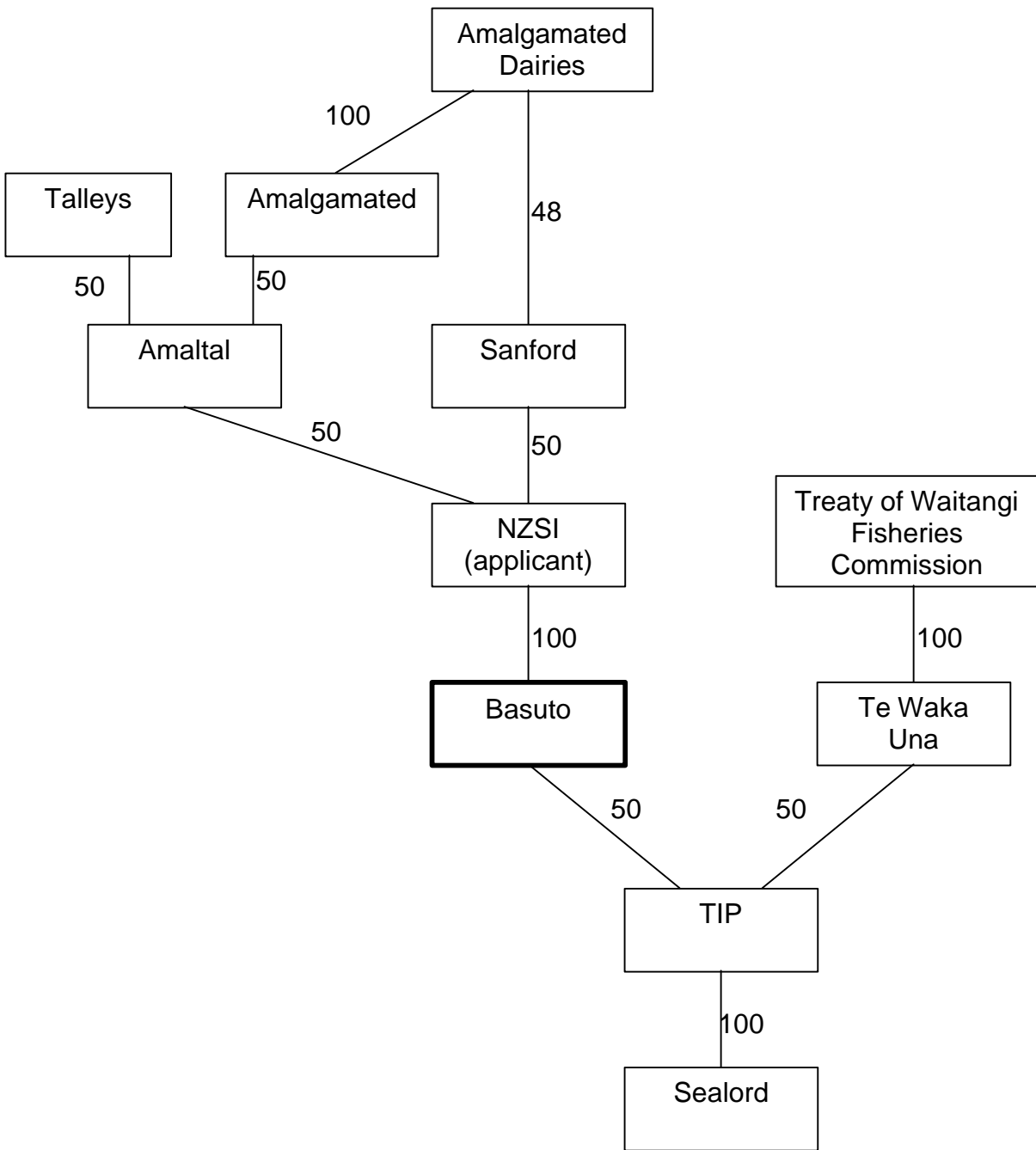
DETERMINATION ON NOTICE OF CLEARANCE

- 324 Pursuant to section 15(5) and section 15(6) of the Act, issues before the Commission (including issues before a division of the Commission) shall be determined by majority vote, and in the event of an equality of votes, the Chairman shall have a deliberative vote and also a casting vote.
- 325 The Chairman, Mr Belgrave, and Deputy Chairman, Mr Berry, determined to clear the application. Commissioners Brown and Coutts dissented. The Chairman exercised his casting vote in the same manner as his deliberative vote.
- 326 Accordingly, pursuant to section 66(3)(a) of the Act, the majority of the division of the Commission determines to give clearance for the proposed acquisition by New Zealand Seafood Investments Limited of 100% of the shares in Basuto Investments Limited.

Dated this 23rd day of March 2000

M J Belgrave
Chair

APPENDIX A



APPENDIX B: Management areas for Ling

DISSENTING OPINION OF K M BROWN AND E M COUTTS

INTRODUCTION

1. Having regard to the various elements of section 3(9) of the Commerce Act 1986 (the Act), and all other relevant factors, Commissioners Brown and Coutts are not satisfied that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.
2. The reasons for the dissenting opinion, which relate primarily to timing constraints and market definition, follow.

THE PROPOSAL

3. In a notice to the Commission dated 7 March 2000, pursuant to section 66(1) of the Act, New Zealand Seafood Investment Limited (NZSI) sought clearance to acquire a 100% share of Basuto Investments Limited (Basuto). Basuto controls 50% of the shares in the Sealord Group Limited.

THE PROCEDURES

4. The application was received on 7 March 2000. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of two working days, sought by the Commission, was agreed by the applicant. Accordingly, a decision was required by 23 March 2000.
5. As NZSI's initial indicative bid for Basuto had to be submitted by 24 March 2000 and accompanied by any necessary clearances, NZSI asked the Commission to consider the application urgently. In the view of Commissioners Brown and Coutts, the time constraint which precluded any extension past 24 March 2000, did not give the Commission sufficient time to analyse all the material competitive effects of, and to make an informed and considered decision in respect of, the application.
6. Commissioners Brown and Coutts agree with the text of Decision 388 through paragraphs 4 and 79 of the majority decision. The divergence of opinion rests primarily with the market definitions, and subsequent competition analysis.

Market Definition

Introduction

7. The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

8. Section 3(1A) of the Act provides that:

“...the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them”

9. Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,²² and in the Commission’s *Business Acquisitions Guidelines* (the Guidelines).²³ A brief outline of the principles follow.

10. Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products which are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. **A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn** (emphasis added).

11. A properly defined market includes products which are regarded by buyers or sellers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension). And are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a “small yet significant and non-transitory increase in price” (the “*ssnip*” test), assuming that other terms of sale remain unchanged.

12. Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the “manufacturing market”, while that between wholesalers and retailers is usually known as the “wholesaling market”.

13. Commissioners Brown and Coutts do not believe that these principles have been applied in this decision. The market definitions decided upon by the majority are at the broadest level, rather than the smallest product and geographical space that might apply and provide market dominance. Commissioners Brown and Coutts believe that there could be specialised, perhaps even regional and seasonal, markets for fresh fish which could not be fully considered because of the time constraint. Likewise, the belief of Commissioners Brown and Coutts that there could be a domestic market for fresh fish, distinct from the

²² (1991)4 TCLR 473.

²³ Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

frozen domestic fish market and the export markets, could not be fully considered because of the time constraint.

14. Paragraph 90 of the majority decision records that the listing of prices for various species of fish was taken to mean:

“That overlapping substitutability between species at adjacent quality/price levels should result in a chain of substitutability stretching from the premium quality to the budget quality species. On this basis, all major finfish species would fall within the same product market.”

15. Commissioners Brown and Coutts do not accept this argument. They believe it is just as likely that there are some discrete groupings of fish that will follow the pattern suggested above. In addition, other consumer responses, including foregoing acceptable species of fish, are at least as likely as the idea of overlapping substitution which lead to the conclusion that there is one market. Again, the time constraint prevented any consideration of empirical evidence and industry data to see whether they supported either the argument or the conclusion.

16. Paragraph 108 of the majority decision records that the market defined for analysing all the material competitive effects of the acquisition is:

- “The market for the processing and wholesale supply of finfish in New Zealand (the ‘processing market’).”

17. The competition analysis in the majority decision is based upon this broad market definition. Because Commissioners Brown and Coutts are not convinced that this market definition is appropriate for analysing all the material competitive effects of the acquisition, they cannot accept the result of the competition analysis and the conclusions drawn from it.

18. Other markets were also part of the application and decision. While Commissioners Brown and Coutts have fewer concerns about those markets, again the time constraint precludes them from being able to agree with the majority decision that there are no competition concerns in those markets.

19. Having regard to the various elements of section 3(9) of the Act, and all other relevant factors, Commissioners Brown and Coutts are not satisfied that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

20. Therefore, Commissioners Brown and Coutts consider that the Commission should decline to give clearance for the proposed acquisition by New Zealand Seafood Investments Limited of 100% of the shares in Basuto Investments Limited.

K M Brown
Commissioner

E M Coutts
Commissioner

