

COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

28 September 2010

The Registrar
Market Structure Group
Commerce Commission
PO Box 2351
Wellington
registrar@comcom.govt.nz

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

PART I: TRANSACTION DETAILS

1 The person giving notice

This notice is given by:

Sanford Limited
22 Jellicoe Street
Freemans Bay
PO Box 443
Auckland

Telephone: +64 9 379 4720
Facsimile: +64 9 379 5930
Website: www.sanford.co.nz

Attention: Eric Barratt

All correspondence and notices in respect of the application should be directed in the first instance to:

Chapman Tripp
10 Customhouse Quay
PO Box 993
Wellington

Telephone: +64 4 499 5999
Facsimile: +64 4 472 7111

Attention: Neil Anderson / Scott Clune
Email: neil.anderson@chapmantripp.com / scott.clune@chapmantripp.com

2 **The other merger parties**

The other merger parties constitute the Pacifica Seafoods Group (*Pacifica Seafoods Group*). This constitutes the following companies:

- (a) Pacifica Seafood (Christchurch) Limited;
- (b) Marlborough Mussel Co Limited;
- (c) Aqua King Limited;
- (d) Pacifica Seafoods (Dunedin) Limited; and
- (e) ITQ Management Limited.

The members of the Pacifica Seafoods Group are all wholly owned subsidiaries of Skeggs Group Limited. The address for the main processing facility of Pacifica Seafoods is:

2 Matipo Street
PO Box 8696, Riccarton
Christchurch, New Zealand

Telephone: 021 424195
Email: bryan@pacificaco.nz
Website: www.pacificaco.nz

Attention: Bryan Skeggs

3 **Ownership and control of the merger parties**

3.1 ***Sanford***

Sanford is an Auckland based fisheries company, listed in the NZSX market operated by New Zealand Stock Exchange Limited. Its shares are widely held. Its largest shareholder, Amalgamated Dairies Limited, holds 37.4% of Sanford directly. No other shareholder holds more than 10%. The 20 largest shareholders are set out at page 71 of the Sanford 2009 Annual Report, which is available online at www.sanford.co.nz/sanford/investorinformation/company_reports_new.

3.2 ***Pacifica Seafoods Group***

The Pacifica Seafoods Group companies are all held by Skeggs Group Limited. Skeggs Group Limited is a narrowly held company. Its four shareholders are:

- (a) Whitby Investments Limited;
- (b) Skeggs Investments Limited;
- (c) Partique Investments Limited; and

(d) Arica Investments Limited.

Whitby Investments Limited's full allocation of shares is held by:

(a) the trustees for the Graeme Skeggs Family Trust, Graeme Bruce Skeggs and Ross Hannay McKechnie; and

(b) Maitai Trustee Company No 31 Limited.

Skeggs Investments Limited's full allocation of shares is held by the trustees of Okiwi Trust, David George Skeggs, Leslie Hugh Wilson and Michael John Turner.

Partique Investments Limited's full allocation of share is held by Bryan John Skeggs, Graeme Bruce Skeggs and Anthony John Mark Healey.

Arica Investments Limited's shares are held 99% by A Anderson and K G Ellwood, and 1% by David George Skeggs.

Essentially, the beneficial ownership of Skeggs Group Limited, and the Pacifica Seafoods Group companies, is narrowly held among a small group of individuals.

3.3 ***Pre-existing links between the merger parties***

Sanford and Pacifica, along with the other three largest mussel processing businesses in New Zealand, have recently formed a joint company, Pure New Zealand Greenshell Mussels General Partners Limited, to market mussels in China under a single brand.

On 27 May 2010, full particulars were notified to the Commission pursuant to section 44(1)(g) of the Commerce Act 1986.

Sanford and Pacifica each have a 25% holding in Shellfish Production and Technology New Zealand Limited. The purpose of this company is the development of hatcheries to produce mussel spat for cultivation in mussel farms.

4 **Details of the acquisition**

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5 **Commercial rationale for the merger**

The rationale for Sanford to pursue the merger is broadly as follows:

- (a) an increase in farming and processing capacity for mussels to improve Sanford's ability to meet demand. Sanford currently has limited spare processing capacity, whereas Pacifica has substantial underused processing capacity;
- (b) a reduction in costs associated with supplying the international seafood markets, brought about by realising further economies of scale;
- (c) the opportunity to introduce technologies that have been successful for Sanford into the Pacifica Group companies; and
- (d) the growth potential in export markets and the New Zealand Government's desire to support the expansion of the aquaculture industry.

6 **Merger documentation**

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7 **Overseas notification**

The merger parties have not notified any other competition authorities of the planned acquisition.

PART II: THE INDUSTRY

8 **Goods and services supplied**

The New Zealand aquaculture industry is mainly concerned with the production of three products: New Zealand Greenshell Mussels; New Zealand King Salmon; and New Zealand Pacific Oysters. Sanford is diversified across all three species. Pacifica is mainly concerned with mussels but also has limited operations in salmon and oysters.

Other species farmed in New Zealand include abalone (paua), eels, and rock oysters, all of which are currently relatively insignificant in terms of value. Research into the large scale production of new species is being performed by institutions such as NIWA and the Cawthron Institute, as well as processing companies.

8.1 ***New Zealand Greenshell Mussels***

New Zealand Greenshell mussels (*Perna Canaliculus*) are native to New Zealand and are only farmed in and exported from New Zealand. They are distinguishable from blue mussels (*Mytilus Edulis*), more common in other parts of the world, by their emerald greenshell, normally larger size and their flavour. They are filter feeders, so they filter their food from the sea by pumping sea water through their gills.

8.2 ***New Zealand King Salmon***

New Zealand King Salmon, also known as Chinook salmon, has the highest oil content of all salmon varieties. It is distinguishable from Atlantic Salmon by the spread of its oil content throughout its flesh (rather than being concentrated under the skin) and because it is not susceptible to Infectious Salmon Anemia (ISA disease), which has severely affected Atlantic Salmon populations in some aquaculture regions of the world. Salmon catch their food in sea water.

8.3 ***New Zealand Pacific Oysters***

The Pacific Oyster was introduced to New Zealand from Asia in the early 1970s. It grew faster and could be farmed more reliably than native New Zealand oysters, and by the mid 1970s it had become the main farm-raised oyster in New Zealand. Currently, most New Zealand farm-raised Pacific Oysters are grown in sheltered, shallow bays around the northern North Island. In the South Island, Pacific Oysters are grown in Tasman Bay, Golden Bay and the Marlborough Sounds. Oysters are also filter feeders.

9 **Industry description**

The aquaculture industry in New Zealand functions at three levels: farming - where stock is cultivated; processing – where stock is processed and made ready for sale; and sale – where the processed stock is sold to wholesalers or retailers. The website of Aquaculture New Zealand (www.aquaculture.org.nz) contains a substantial body of information regarding the industry. The data presented in this paragraph 9 (except the tables at paragraph 9.4, which are Sanford estimates) has been drawn primarily from that website, including in particular the New Zealand Aquaculture Farm Facts booklet.

9.1 ***Farming***

Aquaculture activities in New Zealand occupy 0.02% of New Zealand’s coastline and take place within about 15,800 hectares of allocated water space.

Mussels

There are over 1,000 entities authorised to grow mussels in New Zealand. The following table sets out where mussel farming occurs around New Zealand based on volumes:

Area	Percentage volume of total production
Marlborough	68%
Coromandel	22%
Auckland	3%
Tasman and Golden Bays	3%
Southland	3%
Canterbury	1%

Mussel farming is organic, with the only man-made components being the floats, ropes and anchors that provide support for the mussels while they grow. All mussel farming in New Zealand is conducted via the long-line backbone system (unlike dredging methods typically used in Europe). The long-line system includes plastic floats with two strong parallel ropes (normally over 110 metres in length). The cultivation rope hangs in loops of 5 to 10 metres in depth from the long-line backbone. The long-lines are anchored at both ends, typically with a cement block. When the mussels are ready to be harvested, the lines are pulled onto a specially designed vessel and the mussels are stripped from the rope.

Salmon

New Zealand is the largest producer of farmed King Salmon in the world, where uniquely no antibiotics, growth promotants or vaccines are used in salmon farming practices. All salmon farmed in New Zealand are traceable back to a select number of hatcheries operating in New Zealand, with most hatcheries operating around Marlborough and Southland. The following table sets out where salmon farming occurs around New Zealand based on volumes:

Area	Volume of total production
Marlborough	75%
Southland	19%
Canterbury	6%

They are grown in sea cages in accordance with best practice standards for animal welfare. They take around 12-18 months to grow in sea water, and depending on market requirements are harvested at an average weight of approximately 3.5-4.0 kilograms.

Oysters

Currently, most farm-raised oysters are grown on wooden racks in sheltered, shallow bays around the northern North Island. They can be grown to market size (around 80-100mm) within 12-18 months. The following table sets out where oyster farming occurs around New Zealand based on volumes:

Area	Volume of total production
Northland	47%
Auckland	26%
Coromandel	21%
Marlborough	5%
Tasman and Golden Bays	1%

9.2 **Processing**

Mussels

All mussel processing takes place onshore, with natural waste product deposited back into the sea. The extent of processing required differs depending on the end product for sale or export. The various forms are set out below including the percentages in which they were exported in 2008 and the processing required for each:

Half shell frozen	84.05%
Meat frozen	8.73%
Whole frozen	3.79%
Preserved/marinated	1.35%
Live	1.29%
Freeze dried powder	0.61%
Other not live/chilled/frozen	0.06%
Meat chilled/fresh	0.03%
Whole chilled	0.02%
Smoked	0.02%
Processed in Can, Jar	0.02%
Half shell fresh/chilled	0.02%
Powder in capsule	0.01%

Salmon

The extent of processing required differs depending on the end product for sale or export. The various forms are set out below including the percentages in which they were exported in 2008 and the processing required for each:

Chilled whole	57.47%
Frozen headed and gutted	22.27%
Processed smoked	7.18%
Frozen other form	3.34%
Chilled headed and gutted	3.27%
Frozen whole	1.56%
Frozen fillets	1.55%
Processed cans, jars, whole or in pieces	1.44%
Chilled fillets	1.12%

Chilled other form	0.60%
Processed Cans, jars, minced	0.16%
Processed other	0.04%

Oysters

The extent of processing required differs depending on the end product for sale or export. The various forms are set out below including the percentages in which they were exported in 2008 and the processing required for each:

Frozen half shell	75.72%
Live chilled	14.23%
Chilled half shell	6.14%
Frozen meat	1.76%
Frozen whole	0.72%
Chilled meat	0.71%
Chilled whole	0.50%
Other forms	0.12%
Prepared can, jar	0.10%

9.3 **Sale**

In total, aquaculture in New Zealand is currently worth over NZ\$350 million. The majority of aquaculture products farmed in New Zealand are exported, with exports contributing around NZ\$265 million to New Zealand's economy and accounting for approximately 66% of New Zealand's total aquaculture production. In 2008 New Zealand had 72 active export markets for mussel, salmon and oyster products.

In 2008, by product:

- (a) mussels accounted for 86% of total aquaculture exports (by volume) and 77% (by value);
- (b) salmon accounted for 9% of total aquaculture exports (by volume) and 17% (by value);
- (c) oysters accounted for 5% of total aquaculture exports (by volume) and 6% (by value).

Mussels

In 2008, 84% of all mussel sales by New Zealand producers went to export markets. The international demand for mussels continues to grow steadily, driven by the overall demand for seafood products, the species versatility and the relative affordability and availability of mussels.

The key markets for mussels include North America (which accounted for 33% of mussel exports in 2009), Asia, Europe, Australia and New Zealand. The great majority (84.05% in 2008) of mussel exports are sold in half shell frozen form.

New Zealand remains an important market for mussels, where they are sold into retail supermarkets, food service and nutraceuticals segments. The retail supermarkets and food service segments primarily demand live and some marinated mussels. The nutraceuticals segments represent good demand for meat products which they use for conversion into a range of powder and oil health supplements.

The owners of the five largest mussel processing businesses in New Zealand have recently formed a joint company, Pure New Zealand Greenshell Mussels General Partners Limited, to exclusively market mussels in China under a single brand.

Salmon

In 2008, New Zealand exported NZ\$43.9 million worth of salmon. Since 1980 the world market for salmon has increased more than four-fold, with the growth of farmed salmon being a major driver. Globally, salmon demand continues to increase at over 5% per annum. Driven by tight supply conditions, international prices are currently at record levels.

The key markets for New Zealand farmed salmon in 2009 included Japan (52% of volumes); the United States (16%); Australia (14%); and Taiwan (13%). The majority of exports are in chilled whole form (accounting for 57.47% of total exports in 2008) followed by frozen headed and gutted.

Oysters

In 2008, NZ\$16.9 million worth of oysters was exported to global markets. In 2009 key export markets included Australia (accounting for 51% of all exports); French Polynesia (11%); Hong Kong (8%) and New Caledonia (8%). Global demand for oysters continues to grow. They are predominantly exported in the Frozen Half Shell, Live Chilled and Chilled Half Shell formats.

9.4 *Industries affected by proposed merger*

Sanford is a diversified business that has operations in respect of all three major aquaculture species. However, this application focuses on the effects of the merger on markets related to mussels. This is because:

- (a) Pacifica only has substantial operations with respect to mussels. While Pacifica does have limited salmon and oyster operations we do not think the resulting aggregation is significant; and
- (b) In the both the oyster and salmon markets the merged entity will still have lower market share than the market leader. This can be seen in the tables below which set out the processing market share of salmon and oyster stock in New Zealand.

Oyster processing (NZ)		
Sanford estimated share of volumes by processor (dozen) approximate		Percentage
Pacific Marine /Kia Ora Seafoods	[]	[]
Sanford	[]	[]
Pakihi Marine Farms / Cleavdon Coast Oysters	[]	[]
Biomarine	[]	[]
Ohiwa Marine Oysters	[]	[]
Pacifica	[]	[]
Waiheke Fresh	[]	[]
Aquarius Fisheries	[]	[]
Coromandel Oysters	[]	[]
Sea harbour Sea Products	[]	[]
Total market	[]	[]
<i>Merged entity</i>	<i>[]</i>	<i>[]</i>

Salmon Processing (NZ)		
Sanford estimated share of volumes by processor (tonne)		Percentage
NZ King	[]	[]
Sanford	[]	[]
Akaroa Salmon	[]	[]
Anatoki Salmon	[]	[]
Benmore Salmon/ Aoraki/Whitecloud	[]	[]
Mt Cook Salmon	[]	[]
Pacifica	[]	[]
Leslie Salmon	[]	[]
High Country Salmon	[]	[]
Total market	[]	[]
<i>Merged entity</i>	<i>[]</i>	<i>[]</i>

10 Industry trends

The aquaculture industry in New Zealand has substantial potential for growth. The industry, central and regional government, iwi and research and development providers are all currently engaged in implementing a strategy to develop the aquaculture in New Zealand. The further development of this export oriented industry would be highly beneficial for New Zealand economy.

The New Zealand Aquaculture Strategy was launched on 28 July 2006 at the annual New Zealand Aquaculture Conference in Nelson. The aquaculture strategy describes the actions that industry, central and regional government, iwi and science providers will need to take to support the industry's overall goal. The goal of the aquaculture strategy is that by 2025 the New Zealand aquaculture sector will have sales of NZ\$ 1 billion per annum.

The New Zealand Aquaculture Strategy was endorsed by government who issued a response setting out how it would play its part in realising the strategy's goal. The five key pillars in the government's commitment are:

- (a) Building the confidence to invest
- (b) Improving public support
- (c) Promoting Māori success
- (d) Capitalising on research and innovation
- (e) Increasing market revenues

Although the Ministry of Fisheries is the lead for aquaculture in New Zealand, aquaculture has become a whole-of-government initiative. This is because sustainable aquaculture involves a range of considerations - e.g. coastal planning, customary rights and environmental management.

The Ministers of Fisheries, Conservation, Economic Development, Environment, Local Government and Māori Affairs are closely interested in the development of sustainable aquaculture. Chief executives from these government agencies meet on a regular basis to address aquaculture issues.

Beyond this, a team of staff across these agencies coordinates and implements aquaculture initiatives in partnership with industry, Māori and local government. This Aquaculture Implementation Team meets regularly and is coordinated by the Ministry of Fisheries.

The New Zealand government has also developed a National Aquaculture Position Statement. The guiding principles behind the position statement include maximising economic benefits, stewardship, promoting innovation, Māori participation and good governance.

10.1 *Innovation*

Supported by the New Zealand Aquaculture Strategy, innovation is facilitating growth and enhancing efficiency in the aquaculture industry. This innovation manifests in new technologies and processes.

For example, the Sanford processing plant in Havelock currently processes approximately 4.5 tonnes of mussels per hour. This is expected to increase to approximately 6 tonnes per hour, in part through the introduction of a new automatic opening machine.

Further innovation has the potential to materially improve harvesting yields, including, for example, development of new harvesting techniques for mussels that minimise stress on the stock.

10.2 *Current state*

Aquaculture in New Zealand is highly export oriented with 66% of production destined for overseas markets. Aquaculture, along with other New Zealand export industries has suffered in recent times from a combination of the global financial crisis and a strong New Zealand dollar.

These factors have driven down the prices obtainable for aquaculture product and put pressure on the industry generally. The viability of a number of businesses has been tested in this environment – a situation not unique to the aquaculture industry.

The industry response to these challenges has included forming Pure New Zealand Greenshell Mussels General Partners Limited and also Shellfish Production and Technology New Zealand Limited (as noted above).

11 **Recent merger activity**

Apart from the transactions already mentioned at paragraph 3.3 above, in July 2009, Sanford purchased some of Sealord's mussel farms in the Marlborough Sounds. The package of marine farms included 240 hectares of waterspace and equipment for growing mussels and spat. The purchase was made in part due to Sealord's stated intention to concentrate on developing its holdings in Tasman Bay and the Coromandel.

PART III: MARKET DEFINITION

12 **Horizontal aggregation**

12.1 *Product market*

In the past, the Commission has analysed the following applicable markets:

- (a) the market for the cultivation and supply of greenshell mussels in New Zealand; and
- (b) the market for the processing and supply of shellfish in New Zealand.

The acquisition will result in aggregation in these markets. As noted above though we do not consider the proposed merger would have material competitive effects in markets relevant to salmon or oysters. Accordingly, discussion in this application focuses on three markets:

- (a) the market for the cultivation and supply of greenshell mussels in New Zealand ("**farming**")
- (b) the market for the processing and supply of greenshell mussels in New Zealand ("**processing**"); and
- (c) the market for the wholesale supply of processed greenshell mussel products in New Zealand ("**sale**").

12.2 **Functional level**

The three markets noted above are all functional levels of the supply chain for processed mussel products.

Both the Pacifica Group and Sanford are vertically integrated. All participants in the mussel processing market are vertically integrated to some degree. Most source some of their raw product from independent contract farmers but produce the majority of it themselves.

12.3 **Geographic area**

The farming market for greenshell mussels is a national market. Greenshell mussels are produced at locations throughout New Zealand – in the Coromandel, Marlborough, Tasman/Golden Bay, Southland and Canterbury.

The market for processing greenshell mussels is arguably narrower. Consumers of these services (that is, harvesters and farmers of the raw product) are constrained in their choices by the costs of transporting raw product for processing. The cost of transport across Cook Strait means that the market is effectively segmented between the North and South Islands.

This dynamic is reflected in the fact that many larger entities in the market have processing facilities in both Islands. Sealord has processing facilities in Nelson and Tauranga, and Sanford has processing facilities in Tauranga and Havelock. Pacifica is an exclusively South Island company, operating its only processing facility in Christchurch.

13 **Product differentiation**

At all levels of the supply chain, mussel product is largely undifferentiated.

14 **Vertical integration**

As noted at paragraph 12.2, both Sanford and Pacifica Group are vertically integrated entities. As shown in the table below, each entity produces over [] of its raw

product for processing. Importantly, the aggregate level of vertical integration will not change as a result of the merger.

Sanford estimated hectares used for mussel farming in the Marlborough region

Processor	Sanford		Pacifica	
	Hectares	Percentage	Hectares	Percentage
Contract growers	[]	[]	[]	[]
Share farmers	[]	[]	[]	[]
Leased	[]	[]	[]	[]
Processor owned	[]	[]	[]	[]
Total	[]	[]	[]	[]

PART IV: COUNTERFACTUAL

15 The counterfactual scenario

There are several potential outcomes in the event Sanford does not acquire 100% of Pacifica. [

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(a) [

]

(b) [

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(c) [

]

(d) [

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In Sanford’s opinion the most likely counterfactual is the status quo. However, the ongoing commercial viability of all industry players depends to a degree on there being a robust recovery in the industry.

PART V: COMPETITION ANALYSIS

16 Existing competitors

16.1 *The market for cultivation and supply of greenshell mussels in New Zealand*

There are three groups of producers in the market for cultivation and supply of greenshell mussels in New Zealand. They are:

(a) contract growers;

- (b) share farmers; and
- (c) processor owned and leased premises.

Share farmers are participants who have entered into a reasonably long term relationship with a processor, but do have some opportunity to change their allegiance or become a contract grower periodically. Contract growers are largely free from these upstream contractual constraints. These parties can easily switch processors.

In the Marlborough region alone, there are over 900 individual licences for mussel farms operated by either contract growers or share farmers. This represents [] hectares of the [] hectares of farmed water in the area. Essentially, these independent competitors control roughly [] of the market.

Sanford owns or controls [] hectares of farmed water in the Marlborough region. Pacifica owns or controls [] hectares. The merged entity would control [] hectares. Even if share farms connected with Sanford and Pacifica are considered, the merged entity would only hold [] – representing [] of the Marlborough mussel production market – just inside the safe harbours for an unconcentrated market such as this.

16.2 *The market for the processing and supply of greenshell mussels in the South Island*

The market for the processing and supply of greenshell mussels in the South Island will also experience aggregation with the proposed acquisition. The main competitors in this market are:

- (a) Sanford;
- (b) Pacifica;
- (c) ASL;
- (d) Sealord; and
- (e) Talleys.

Using the data set out at paragraph 14 above:

- (a) [] of Sanford's Marlborough mussels are sourced from Sanford owned or leased farms; [] from share farmers; and [] from contract growers.
- (b) [] of Pacifica's Marlborough mussels are sourced from Pacifica owned or leased farms; [] from share farmers; and [] from contract growers.

Processors' ability to compete for raw product from share farmers and contract growers is greatly constrained by two factors:

- (a) the international price per green weight tonne for mussels (currently approximately \$550 per green weight tonne); and
- (b) the cost of trucking and haulage of the raw product to the processing facility.

Haulage per green weight tonne for transit from Southland to Marlborough costs around []. Southland to Christchurch will cost around [] per green weight tonne. Blenheim to Havelock will cost around [] per green weight tonne. Obviously, processors will look to lower their costs, but haulage costs of [] per green weight tonne are significant in the context of a market price of [] per green weight tonne.

Crossing Cook Strait is expensive, and long haul transportation can be uneconomic, meaning the market is regionalised. However, within the South Island, extensive processing capacity will exist after the acquisition. Also, it is worth noting that transportation costs are reasonably fixed so if market prices for processed mussel product increase substantially, it could be viable to transport mussels between the islands.

16.3 *The market for the wholesale supply of processed greenshell mussel products in New Zealand*

The competition between processors to supply domestic New Zealand wholesale and distribution markets is unlikely to be affected by the proposed acquisition. [] of Sanford's [] green weight tonnes of mussels produced per year and [] of Pacifica's [] green weight tonnes, are exported. The merged entity would have supplied [] green weight tonnes to the New Zealand market in the previous reporting year. This represents around [] of the domestic market.

It is unlikely that any entity, including the merged entity, would be able to act unilaterally in this market. Although most product is exported, if margins in domestic markets improved, any of the other players could quickly divert product from export to domestic markets.

Sanford does not maintain data on domestic market share for the wholesale supply of processed greenshell mussel products in New Zealand. However, it is estimated that together Future Cuisine Limited, Talleys, United Fisheries, Westpac Mussels Distributors Limited, Sealord and Aotearoa Seafoods Limited would have in excess of [] market share.

17 **Market share data**

Sanford estimated market share for processing volumes of greenshell mussels in the South Island

Rank	Competitors (including merger parties)	Estimated volume (green weight tonnes)	Estimated % of market by volume
1	Sanford	[]	[]
2	Pacifica	[]	[]
3	Sealord	[]	[]
4	ASL	[]	[]
5	Talleys	[]	[]
6=	Nelson Ranger	[]	[]
6=	Maclab	[]	[]
ETC	<i>Others</i>	[]	[]
Total South Island		[]	

18 **Constraint of competitors**

The merged entity of Sanford and Pacifica would be constrained in its actions by competitors in the relevant New Zealand markets.

18.1 ***King salmon and oysters***

At all levels of the king salmon and oyster market the merged entity would entirely be constrained by the presence of a larger market participant. Relative to a status quo or non-trade acquisition counterfactual, acquisition of Pacifica by Sanford would mean it is better able to act as a constraint on the larger market participants. In these markets then, the proposed acquisition is pro-competitive.

18.2 ***Mussels***

Farming

Both Sanford and Pacifica are largely vertically integrated in terms of farming and processing. Both entities farm lower volumes of stock than they have capacity to process. Accordingly, all stock farmed by Pacifica and Sanford is processed internally. Competitor processors do not depend on acquiring stock from Sanford or Pacifica farms. This means that the merged entity will not have any scope to reduce farming volume and increase the price competitor processors are required to pay for volumes of stock.

Processing/Procurement

The merged entity will continue to source approximately [] of stock for processing from independent farmers. The merged entity will own 3 of 11 mussel processing

plants in New Zealand and will be subject to competition in each of the major farming regions.

Pacifica does not operate in the North Island so the merger is competitively neutral from that standpoint. In the South Island the merged entity will have operations in Christchurch and Havelock. There are 8 other processing plants in the South Island including 2 in Christchurch and 6 in Nelson/Marlborough currently operating. The Pacifica and Sanford plants source independent stock only to extent that its capacity is not utilised by internally sourced stock. Given the relatively small volumes of independent stock sourced from farmers, and the presence of other numerous other processing plants, the merged entity will be constrained from dictating terms to independent farmers.

Export/Domestic market

The merged entity will have a larger share of the key export market. The countervailing power of overseas buyers in the export market is substantial and the merged entity will be better placed to maximise the price of export stock.

Neither Sanford nor Pacifica move substantial processed volumes through the domestic market. To the extent the merged entity attempted to dictate terms on the small volumes it does move, existing competitors could easily step in to meet the demand.

19 Conditions of entry

19.1 Breakdown of the estimated costs

Entry into mussel farming requires comparatively little capital outlay. This is evidenced by the large number of small independent contract growers that operate in the market. In the Marlborough region alone, there are over 900 individual licences for mussel farms operated by either contract growers or share farmers

Entry into processing is a more significant investment. The plant in Tauranga owned by the North Island Mussel Processors Limited JV (in which Sanford is a participant) required capital investment of about \$23 million and has capacity to process around 20,000 tonnes of mussels per year. The tonnage per dollar will decrease as scale decreases so entry at any level represents a significant investment.

Setting up a business as a wholesaler can be accomplished with virtually no outlay. A prospective entrant need only have relationships with buyers and knowledge of where to source processed product. A business could potentially be run with a telephone connection and a desktop PC.

19.2 Anticipated timeframes

Entry into farming can be accomplished quickly. Once a farm is purchased or leased the entrant can start growing straight away. Product would be ready for sale or processing within the life-span of a mussel.

The speed at which a processing operation can be set-up depends on the scale at which the business is proposed to operate. More elaborate set-ups will take longer to establish.

A wholesale business can be set up almost immediately. A prospective entrant need only have relationships with buyers and knowledge of where to source processed product.

19.3 **Regulatory requirements**

Farming

Aquaculture farming requires resource consent. Rapid growth in aquaculture in the 1990s resulted in a large increase in the demand for water space which the regulatory system at the time could not handle due to:

- (a) Increased delays for marine farm applications for new space and rising costs in the processing of resource consent applications, and
- (b) Concern from coastal communities that the full effects of farming were not being suitably recognised or managed.

These concerns resulted in a moratorium on new aquaculture permits between November 2001 and December 2004. The Aquaculture Reform Act 2004, which came into effect on 1 January 2005, brought aquaculture management under the control of regional councils. However, no new aquaculture space was permitted in the ensuing four years. While some new space has been permitted in the last two years, both industry participants and the government still view the system as inefficient and uneconomic. The government has committed to streamlining and simplifying the regulatory regime for aquaculture to enable the industry to fulfil its potential, while still protecting the environment and the interests of other users of the coastal marine area. The government's proposed reforms in the area of aquaculture permitting can be found here: <http://www.fish.govt.nz/en-nz/Aquaculture+Reform/default.htm>

Processing

Processing facilities require registration with NZFSA under the Animal Products Act 1999.

Sale

Exporters require registration with NZFSA under the Animal Products Act 1999.

19.4 **Business requirements involved**

Local and industry knowledge are a requirement of all the markets affected, but in particular in the harvesting and farming sectors, where knowledge and skills are required on start up. The most appropriate sites for marine farming (of any sort) are already occupied, meaning that any new entrant would require a high level of skill in the industry to be able to effectively compete with the incumbents.

Likelihood, extent and timeliness of entry (LET Test)

20 Likelihood of entry

20.1 *Farming*

There are a number of independent contract growers who could expand to meet any increased demand from processors. In addition capital requirements for setting up new farms are relatively low. If there was a sustainable increase in product price or demand we would expect that expansion from existing contract growers and de novo entry of new growers would be very likely.

20.2 *Processing*

There are numerous processing plants that could expand production in response to increased demand. In addition, though the capital required to set-up a new processing operation on an economic scale is significant, there are no other barriers that make entry difficult. Accordingly a sustainable increase in product price or demand would make de novo entry a real possibility.

20.3 *Sale*

Selling of mussels to domestic wholesalers and retailers is almost entirely carried out by processors. Any attempt by the merged entity to restrict supply in this regard would very likely be met by the buyers obtaining alternative arrangements from other processors.

21 *Extent of constraint*

The low capital and other resource requirements for entry and expansion means that if the merged entity would be entirely constrained from acting to increase prices in the domestic market by restricting supply. While de novo entry is a real possibility at all levels in the supply chain, we consider that due to the relatively low level of demand in the domestic market, the real constraint on the merged entity comes from the possibility of expansion of existing firms.

22 *Timeliness of entry*

We expect an operation at any functional level of the supply chain could be set-up relatively quickly. Certainly entry could be achieved quickly enough to act as a material constraint on unilateral action.

23 *Countervailing power of buyers*

Neither Sanford nor Pacifica moves substantial volumes of processed mussel product through the domestic market. The vast majority of stock farmed and processed by Sanford and Pacifica is sold to overseas buyers by Sanford and Pacifica.

Buyers in the New Zealand domestic market (eg supermarkets) have substantial countervailing power. In addition, mussels are a discretionary item, meaning that demand is elastic with movements in price will having significant effects on quantities purchased.

24 **Coordinated market power**

Consistent with The New Zealand Aquaculture Strategy, industry participants engage in a degree of coordination with respect to export of aquaculture products. Sanford and Pacifica, along with the other three largest mussel processing businesses in New Zealand, have recently formed a joint company, Pure New Zealand Greenshell Mussels General Partners Limited, to exclusively market mussels in China under a single brand.

The formation of this export company was notified to the Commission pursuant to section 44(g) of the Commerce Act 1986.

Industry participants do not coordinate with respect to the domestic market. The size of the domestic market relative to the export one is so small that there is no material incentive to coordinate. If there were any effort to coordinate in this regard any existing processor/seller could easily undercut the cartel and supply the small volumes required domestically.

Neither Sanford nor Pacifica moves substantial volumes of processed mussel product through the domestic market. We would expect the merged entity to continue in this regard (subject of course to a material increase in domestic demand and price). We do not think the merger would increase the scope for coordination in any of the relevant markets.

25 **Efficiencies**

The efficiencies gained as a product of the acquisition have already been mentioned under the "Commercial Rationale" heading. Essentially, the merged entity will be in a better position to operate a cost effective business in a challenging trading environment.

PART VI: FURTHER INFORMATION & SUPPORTING DOCUMENTATION

26 **Contact details**

Contact details for certain competitors, buyers and suppliers and other relevant market participants are set out in the table below.

	Name Of company	Contact details	Relevant contact person
	Both legal and trading names	Postal & physical address, telephone and fax, website	Name, position and contact details including telephone, fax, email
Competitors	Sealord Group Ltd	PO Box 11 149 Vickerman Street Nelson T: (03) 548 3069 F: (03) 546 9041 www.sealord.co.nz	Graham Stuart, CEO Email: grs@sealord.co.nz
	Talley's Group Limited	Motueka Head Office P.O. Box 5 Ward Street, Motueka T: (03) 528 2800 F: (03) 528 2805 www.talleys.co.nz	Peter Talley Email: peter.talley@talleys.co.nz
	Aotearoa Seafoods Limited	16 Bristol Street PO Box 762 Blenheim P: (03) 578 2069 www.aotearoaseafoods.co.nz	Keith Palmer, CEO 16 Bristol Street PO Box 762 Blenheim P: (03) 578 2069
Buyers	Foodstuffs New Zealand Ltd	Level 8, 45 Johnston Street Lambton Quay PO Box 5401 Wellington P: (04) 472 6435 F: (04) 472 6412	
	Progressive Enterprises Limited	Private Bag 93306, Otahuhu, Manukau Head Office 80 Favona Rd, Mangere, Manukau P: (09) 275 2788 F: (09) 275 3074	
	The Hairy Mussel Company	PO Box 73, Havelock, Marlborough 7150 P: (03) 574 2575 M: 0274 514 502 http://hairymussel.co.nz/	Tim Madden
Suppliers	Gus Beal	Private Bag, Havelock 9150 T: (03) 579 8263 F: (03) 579 8267 M: 0274 220 7291 bealg@farmside.co.nz	

	John Sinclair	3 Kelson Lane, Ilam, Christchurch 8041 T: (03) 341 8270 F: (03) 341 6367 judy.sinclair@slingshot. co.nz	
	Bruce Hearn	Apex Marine Farms Ltd 59 Houldsworth Street Blenheim 7201 P: (03) 578 6241 M: 027 440 2049 apexhearn@xtra.co.nz	
Trade Associations	Aquaculture New Zealand	Level 1, Wakatu House, Montgomery Square, Nelson 7010 P: (03) 548 8944 F: (03) 548 8984	Mike Burrell, CEO M: 021 244 4155 mike.burrell@aquaculture.org.nz
	Marine Farming Association	PO Box 86 1 Main Street Blenheim 7201	Graeme Coates, Executive Officer P: (03) 578 5046 M: 027 445 4389 graeme@marinefarming.co.nz
	SeaFiC	New Zealand Seafood Industry Council Private Bag 24-901 Wellington 6142	Peter Bodeker, CEO P: (04) 385 4005 F: (04) 385 2727 M: 027 499 8328 Peter.Bodeker@seafood.co.nz
Any other relevant market participants or interested parties	Ministry of Fisheries	Head Office ASB Bank House 101 - 103 The Terrace PO Box 1020 Wellington P: (04) 819 4600 F: (04) 819 4601	Wayne McNeen Chief Executive Ministry of Fisheries wayne.mcneen@fish.govt.nz Dan Lees Director of Aquaculture Ministry of Fisheries Nelson (Regional Office) 118 Vickerman Street Port Nelson Private Bag 14 Port Nelson 7042 P: (03) 548 1069 F: (03) 545 7799 dan.lees@fish.govt.nz

27 **Annual reports and financial statements**

Sanford's most recent annual report is available at www.sanford.co.nz. Separate management accounts for the aquaculture division are attached as an appendix to this application. We suggest the Commission contacts Pacifica directly to obtain relevant information regarding that group of companies.

PART VII: CONFIDENTIALITY

28 **Confidential version of the application**

Sanford requests (in terms of section 9(2)(b)(ii)) of the Official Information Act 1982) confidentiality in respect of the specific information set out in the attached schedule on the basis that the making available of the information would be likely unreasonably to prejudice the commercial position of Sanford.

That information is square bracketed from this confidential version of the application and redacted from the public version of the application (provided together with this application).

29 **Declaration**

THIS NOTICE is given by Sanford Limited:

Sanford Limited hereby confirms that:

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

We undertake to advise the Commission immediately of any material change in circumstances relating to the application/notice.

Dated this 28 day of September 2010



On behalf of Sanford Limited:

By Eric Barratt, Managing Director, Sanford Limited *

*I am duly authorised to make this application/notice.

APPENDIX

**[MANAGEMENT ACCOUNTS FOR THE AQUACULTURE DIVISION OF
SANFORD]**