



COMMERCE COMMISSION

**Decision No. 658**

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

**TEGEL FOODS LIMITED**

and

**BRINKS GROUP OF COMPANIES**

**The Commission:** Paula Rebstock  
Peter JM Taylor  
Anita Mazzoleni

**Summary of Application:** The business acquisition for which clearance is sought is the purchase by Tegel Foods Limited of the assets and undertaking of the poultry business of P H Van den Brink Limited, VDB Industries Limited, Brinks South Island Limited, Southland VDB Limited and BAT Promotions Limited.

**Determination:** Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline clearance to the proposed acquisition.

**Date of Determination:** 22 October 2008

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## GLOSSARY

Breeder Stock	Used in this document to mean any of Great Grandparents, Grandparents or Parents, as opposed to Broiler Chickens.
Broiler Chicken	A male or female chicken grown for meat production and less than 8 weeks old.
DOC	Day Old Chicken, used in this document to mean day old birds to be grown as Broiler Chickens.
EOL	End of Lay birds. Layer Hens that have reached the end of their laying potential and are sent for killing and processing. These birds may be processed for meat.
Further Processing	Processing of chicken using specialised automatised facilities to produce higher value products that cannot be produced by hand. Requires high technology batch or in-line processing equipment. Includes the production of fully cooked, formed, coated, or flash fried products. Products include chicken nuggets or fully cooked fillets.
Grandparents (GPs)	Used to breed Parent chickens.
Great Grandparents (GGPs)	Initial pure breeding line, used to breed Grandparent chickens.
Growers	Farmers who are contracted to grow Broiler Chickens from DOCs to an age at which they are viable for primary processing.
Hatchery	A facility for hatching fertile eggs into either Parents or DOCs.
NZFSA	New Zealand Food and Safety Authority
Parent	Used to breed DOCs to be used for meat consumption.
PIANZ	Poultry Industry Association New Zealand
Primary Processing	The process of killing, plucking and eviscerating a chicken to its bare carcass known as a dressed whole bird.
Secondary Processing	The process of cutting and de-boning a dressed whole bird into specific smaller cuts of meat (for example, breasts or drums).
Smallgoods	Generic term for chilled, ready to eat processed boutique products. Smallgoods products are not exclusively chicken based and also include ham, bacon, salami and pastrami. Chicken smallgoods products include smoked chicken, sliceable roasts, chicken luncheon, sausages and bacon.
QSR	Quick Service Restaurants, meaning large multinational (often franchised) fast food chains who require a combination of large volumes, very specific product specifications and have high service levels of performance. These requirements distinguish them from other more general take away food outlets. (QSRs are: KFC, McDonalds, Burger King, Hell Pizza, Wendys, Subway and Red Rooster)

## EXECUTIVE SUMMARY

### Introduction

- E1. The Commerce Commission (Commission) received an Application from Tegel Foods Limited (Tegel) to acquire the poultry businesses of P H Van den Brink Limited, VDB Industries Limited, Brinks South Island Limited, Southland VDB Limited, and BAT Promotions Limited, collectively known as Brinks.
- E2. The issue for the Commission to decide is whether it is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.
- E3. The Commission must assess whether there is a real and substantial risk that there will be more than a minimal lessening of competition.<sup>1</sup> The Commission compares two situations: one with the acquisition proceeding (factual); and one without the acquisition (counterfactual(s)). The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in a market between the factual and the counterfactual.
- E4. The Commission has declined the application as it could not be satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a number of affected markets.

### Background

- E5. The New Zealand poultry industry processed around 85 million chickens in 2007. The production of chicken products comprises a number of distinct steps that can be separated into upstream and downstream activities. Upstream activities include the production of breeding stock, day-old-chicks (DOCs) and chicken feed, and the growing of broiler chickens. Downstream activities include the processing and supply of chicken products.
- E6. Chicken processors supply their products to three main customer groups: supermarkets; food service providers; and Quick Service Restaurants (QSR), such as KFC and McDonalds.
- E7. The acquirer, Tegel, is a vertically-integrated poultry growing and processing company with its own hatcheries and breeding facilities, feed mills, and processing plants in the North and South Island. The company supplies fresh and frozen whole dressed chickens and cut up chicken pieces, as well as processed chicken products such as kebabs and patties. Tegel supplies supermarkets, food service providers and QSR customers throughout New Zealand. In 2007, the company processed approximately [ ] million chickens in New Zealand.
- E8. The business activities of Brinks, the target, involve the growing and processing of chickens in both the North and South Island. The company is not vertically integrated as it does not operate its own hatcheries and breeding facilities. Brinks supplies fresh and frozen whole dressed chickens and cut-up pieces to supermarkets and food service customers throughout New Zealand. In 2007, the company processed approximately [ ] million chickens in New Zealand.

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<sup>1</sup> *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No. 6)* (2004) 11 TCLR 347; *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679; *Fisher & Paykel Limited v Commerce Commission* [1996] 2 NZLR 731; *Port Nelson Limited v Commerce Commission* [1996] 3 NZLR 554.

- E9. Other companies in the industry include Inghams, Turks and Spring Chicken.
- E10. Inghams Enterprises (NZ) Pty Limited (Inghams) is a vertically-integrated poultry company with its own North Island feedmills, breeding operations, contract growing and processing operations. In 2007, the company processed approximately [ ] million chickens in New Zealand.
- E11. Turks Poultry Limited (Turks) is a partially vertically-integrated North Island poultry company. Like Brinks, Turks grows broiler chickens and processes and sells chicken products. In 2007, the company processed approximately [ ] million chickens in New Zealand.
- E12. Spring Chicken Limited (Spring Chicken) started chicken processing in June 2008 as a fully vertically integrated operator. Spring Chicken operates a processing plant and feedmill in the North Island. Initially, Spring Chicken also had its own breeding operations and hatcheries. However, after experiencing initial problems the company decided to discontinue its breeding and hatchery operations. On a pro-rata basis, Spring Chicken currently processes approximately [ ] million birds per annum.

### **The Relevant Markets**

- E13. For its analysis, the Commission first must define the relevant markets affected by the proposed acquisition in order to assess the likely competition effects.
- E14. The Commission concluded that chicken products form a distinct market from other forms of animal protein as qualitative and quantitative evidence indicated limited degrees of demand and supply-side substitutability between these products.
- E15. With regard to the functional dimensions of the relevant markets, the Commission concluded that each of the steps of the chain of production, i.e. breeding, growing, and processing, form distinct functional dimensions.
- E16. With regard to the customer dimension of the affected markets the Commission concluded that processors can readily distinguish and price differentiate between supermarket, food service and QSR customers. Each of these customer groups therefore forms a distinct market.
- E17. In respect of the geographic dimension of the affected upstream markets, the Commission found that the supply of:
- chicken breeding stock is national due to the high value and transportability of stock;
  - DOCs is regional due to limited transportability of the animals;
  - growing services is regional due to limited transportability of grown chickens; and
  - chicken feed is regional due to the product's high-volume-low-margin characteristics.
- E18. With regard to the affected downstream markets, the Commission concluded that the effects of the proposed acquisition on competition are best assessed under separate North Island and South Island markets. This is because of four main factors that relate to chicken products transported from the North to the South Island: transport costs; volume of chicken transported; reliability of supply; and customers' requirements in terms of minimum shelf life.
- E19. In its analysis, the Commission found that only limited amounts of chicken products are transported on a regular basis from the North Island to supermarkets and food service

providers in the South Island. Further, suppliers without processing facilities in the South Island make either no or limited sales in the South Island to these customers.

- E20. Transporting significant volumes of products on a regular basis across the Cook Strait adversely affects the level of security of supply. This prompts the need for a South Island distribution centre and the maintenance of several days worth of ‘buffer stock’. Buffer stock kept by a North Island processor in a South Island distribution centre will allow that processor to accommodate varying levels of demand and supply interruptions of fresh stock.
- E21. Taking into account the time it takes to process chickens, transporting the processed products from the North to the South Island, storing them in a distribution centre for a number of days before delivering them to supermarket and food service customers across the South Island, the Commission considered that such products would not satisfy customers’ minimum shelf life requirements.
- E22. Compared to supermarket and food service customers, QSR customers tend to have significantly lower minimum shelf life requirements. The Commission also noted that Inghams supplies KFC restaurants throughout New Zealand from its North Island processing facilities.
- E23. The Commission concluded that the markets that would be affected by the proposed acquisition are:
- Upstream markets:
    - i. the national market for the supply of chicken breeding stock;
    - ii. regional markets for the supply of DOCs;
    - iii. regional markets for the provision of chicken growing services; and
    - iv. regional markets for the manufacture and supply of chicken feed.
  - Downstream markets for the wholesale supply of primary and secondary processed chicken products to:
    - i. North Island supermarkets;
    - ii. South Island supermarkets;
    - iii. North Island food service providers;
    - iv. South Island food service providers; and
    - v. QSR customers throughout New Zealand

### **Factual and Counterfactual**

- E24. In the factual scenario (with the acquisition), Brinks would be removed as a competitor in the affected downstream poultry markets, and as an acquirer of key inputs in the upstream markets. Tegel would internalise all of Brinks’ operations and there would be a restraint of trade preventing Brinks from re-entry in a reasonable time period.
- E25. In the factual, the number of major players would effectively be reduced from three to two in the North Island supermarket and food service markets, and from two to one in the South Island supermarket and food service markets.
- E26. In the counterfactual scenario (without the acquisition), the Commission considered that there is a real prospect that Brinks would continue to operate in the same way it

currently does or that its operations, or part of its operations, would be purchased and maintained by an independent third party.

### **Competition Analysis – Upstream Markets**

- E27. With regard to the four upstream markets the Commission considered that aggregation would only occur in respect of the provision of growing services. However, the Commission considered that that aggregation would be unlikely to raise any competition concerns.
- E28. Further, the Commission is of the view that there would be no material change in accessibility of upstream inputs as a result of the proposed acquisition. The Commission concluded that there would be no strengthening of existing vertical links as a result of the proposed acquisition. Consequently, the Commission was satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in these markets.

### **Competition Analysis – Downstream Markets**

#### *The North Island Supermarket Market*

- E29. The proposed acquisition would reduce the number of large chicken processors in the North Island from three to two, with two smaller fringe players still remaining, and result in significant additional aggregation in an already concentrated market.
- E30. In the factual, the combined entity's main competitor would be Inghams. While there is some evidence that Tegel and Inghams compete, there is also evidence suggesting that these parties aim at maintaining profitability, [ ]
- E31. [ ] Turks is likely to do so in both the factual and the counterfactual and to such an extent that it would not constrain materially the combined entity.
- E32. Spring Chicken is currently not a competitive force in this market. [ ] Given the company's recent entry and start-up problems, there are uncertainties around how the degree of competitive constraint that the company will provide in the future.
- E33. The Commission concluded that the constraint provided by existing competitors would be lower in the factual than the counterfactual. This is because the proposed acquisition would result in the removal of Brinks, a competitor that industry participants described as a price discounting catalyst that contributes to the competitive tension in this market.
- E34. The loss of Brinks as a vigorous competitor in the factual would increase the degree of processors' interdependence and therefore increases the risk of reduced output and increased prices.
- E35. In respect of potential competition, the Commission considered that entry is unlikely to be of sufficient extent, or may not be sufficiently timely, to constrain the combined entity.
- E36. In the counterfactual, supermarkets would have some degree of countervailing power through their ability to switch some volumes between three players. However, with the removal of Brinks in the factual, such switching would become more difficult.
- E37. With regard to coordinated effects, the Commission found that the proposed acquisition would materially increase the scope for coordination in this market as
- the proposed acquisition would be effectively a merger to duopoly;



- Brinks, a vigorous competitor would be removed from the market;
- the industry body may facilitate the sharing of information;
- Tegel and Inghams have considerable knowledge of each other's plants;
- all parties in the industry appear to know each other's prices and would have a reasonable idea of each other's costs;
- demand appears to be relatively price-inelastic which enhances the scope for profitable price rises;
- entry is slow and it takes considerable time to become a significant competitive force;
- there are no imports due to legislation; and
- an over-supply situation in 2005/2006 demonstrated clearly that spare capacity provides a mechanism for punishing deviation from coordination.

E38. Accordingly, the Commission could not be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in this market.

*The North Island Food Services Market*

- E39. Like the North Island supermarket market, the proposed acquisition would reduce the number large chicken processors in the North Island from three to two, with two smaller fringe players still remaining, and result in significant additional aggregation in an already concentrated market.
- E40. In the factual, the combined entity's main competitor would be Inghams. Industry participants described Inghams as a processor that systematically reacts to price increases by Tegel, and who offers prices that are, on average, above those offered by Brinks.
- E41. As for the North Island supermarket market, chicken processors other than Tegel, Brinks and Inghams process limited numbers of chickens and therefore, these companies are unlikely to pose any competitive constraint on larger processors either in the factual or counterfactual. Further, [ ], while there are uncertainties around the degree of competitive constraint that Spring Chicken will pose in the future, given the company's recent unsteady start.
- E42. In respect of the degree of existing competition in this market, the Commission concluded that this would be lower in the factual than the counterfactual. This is because the proposed acquisition would result in the removal of Brinks, a vigorous competitor that industry participants described as price catalyst that contributes to the competitive tension in this market.
- E43. As outlined in the North Island supermarket market, recognition of interdependence might cause firms to modify their behaviour, resulting in lower levels of output and higher levels of prices.
- E44. As for the North Island supermarket market, the Commission considers that the conditions of entry make such entry unlikely within the requisite timeframe of two years.

- E45. Further, given the fragmentation and small size of North Island food service providers, it is unlikely that these customers would have countervailing power sufficient to constrain the combined entity.
- E46. As outlined in respect of the North Island supermarket market, the structure and characteristics of this industry could enhance the scope for coordinated behaviour. The proposed acquisition would increase the likelihood of this outcome materialising.
- E47. Accordingly, the Commission could not be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in this market.

*The South Island Supermarket Market*

- E48. The proposed acquisition would reduce the number of major competitors in the South Island supermarket market from two to one.
- E49. In terms of existing competition, the proposed acquisition would remove the second largest player in this market, and the only one, apart from Tegel with South Island processing facilities.
- E50. In the factual, the combined entity's only competitor would be Inghams. Inghams is currently supplying only limited volumes of largely frozen products. Inghams' ability to effectively supply South Island based customers is impeded by [ ].
- E51. Accordingly, the Commission concluded that, in the factual, the combined entity would be likely to face only a limited degree of competition from the only remaining competitor, Inghams.
- E52. For the same reasons as outlined with regard to the North Island supermarket market, the Commission considers that the merged entity is unlikely to face a constraint from potential competition in this market as, in the factual, entry is unlikely to occur.
- E53. The Commission noted that South Island-based supermarkets represent a significant proportion of Tegel's and Brinks' total sales. Presently, unlike the North Island, South Island supermarkets have limited ability to switch meaningful volumes between processors. With Brinks' removal in the factual, South Island supermarkets would have no ability to switch significant volumes on a regular basis to another processor.
- E54. For similar reasons as outlined with regard to the North Island supermarket market, the Commission considers that the proposed acquisition would enhance the scope for coordination on a national level. Such coordination could take the form of settling on a national level of output that is lower than the competitive level, or forming an understanding not to compete for each other's customers in some or all markets.
- E55. Accordingly, the Commission could not be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in this market.

*The South Island Food Services Market*

- E56. The proposed acquisition would reduce the number of major competitors in the South Island food service market from two to one.
- E57. In the factual, Brinks would be removed from the market resulting in the loss of an important competitor that industry participants described as low price competitor and only realistic alternative to Tegel.

- E58. As for the South Island supermarket market, in the factual, the combined entity's only competitor would be Inghams. Inghams is currently supplying only limited volumes of mainly frozen products into this market. Inghams' ability to effectively supply South Island based customers from its North Island processing plant in the future, is impeded by its lack of South Island processing facilities.
- E59. The Commission found that South Island food service providers have already limited countervailing power due to their fragmented nature.
- E60. Accordingly, the Commission cannot be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in this market.

#### *The QSR Market*

- E61. The Commission considered that Brinks is neither an existing, nor a potential competitor in the QSR market and that the proposed acquisition would therefore not adversely affect the level of competition in this market.

#### **Overall Conclusion in Relation to the Proposed Acquisition**

- E62. The Commission is satisfied that, should the proposed acquisition proceed, it will not have, or would not be likely to have, the effect of substantially lessening competition in four upstream markets. Those markets are for the:
- i. national supply of chicken breeding stock;
  - ii. regional supply of DOCs;
  - iii. regional provision of chicken growing services;
  - iv. regional supply of chicken feed; and
- E63. In respect of four affected downstream markets, the Commission could not be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition. These markets are those for the wholesale supply of primary and secondary processed chicken products to:
- i. North Island supermarkets;
  - ii. South Island supermarkets;
  - iii. North Island food service providers; and
  - iv. South Island food service providers.
- E64. In respect of the remaining downstream market (the national market for processing and wholesale supply of primary and secondary processed chicken products to QSR customers) the Commission was satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in four upstream markets.
- E65. The Commission determines to decline clearance for the acquisition of Brinks by Tegel.

## INTRODUCTION

### The Proposed Acquisition

1. The business acquisition for which clearance is sought is the purchase by Tegel Foods Limited (Tegel or the Applicant) of the assets and undertaking of the poultry business of P H Van den Brink Limited, VDB Industries Limited, Brinks South Island Limited, Southland VDB Limited and BAT Promotions Limited (together, Brinks).
2. The poultry business assets to be acquired comprise brands and intellectual property, sales and marketing data, livestock, feed, finished goods inventories, raw materials and packaging, vehicles, and certain plant and equipment. Brinks proposes to retain the land [ ]. Brinks would also retain buildings and the majority of the plant, [ ].
3. The proposed acquisition of Brinks by Tegel includes a [ ] restraint of trade upon [ ].
4. The Applicant proposes to fully integrate Brinks' operations into Tegel's existing operations.<sup>2</sup> Tegel considers that doing so would enable it to achieve substantial livestock, feed and operating efficiencies through increased plant utilisation involving minimal additional fixed costs.

## THE PARTIES

### The Acquirer: Tegel

5. Tegel is a company registered in New Zealand. Pacific Equity Partners beneficially owns 43.6% of the shares in Tegel.
6. Tegel is a vertically-integrated poultry growing and processing company with its own hatcheries, breeding stock, feed mills, contract growing, processing, and distribution facilities throughout New Zealand. Tegel has processing plants in Auckland, New Plymouth, and Christchurch.
7. In 2007, Tegel, the largest processor in New Zealand, processed around [ ] million birds – [ ] million in the North Island and [ ] million in the South Island. Currently, its plants utilise around [ ]% of their processing capacities. The company supplies branded and unbranded chicken products to supermarkets, quick service restaurants (QSRs), cafes, restaurants, and smaller retailers throughout New Zealand. In addition, Tegel produces further processed products such as chicken nuggets and crumbed chicken patties.
8. Tegel supplies unbranded whole birds to further preparers, producers of smallgoods, and food distributors.
9. Tegel is also involved in the hatching of day old chicks (DOCs) from its hatcheries in the North and South Islands. These are supplied for rearing by Tegel's contract growers as well as for supply to other chicken processors, including Turks Poultry Ltd. [ ]

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<sup>2</sup> This is discussed in more detail in the section on the factual scenario.

### **The Target: Brinks**

10. Brinks is 50% owned by VDB Capital Limited, with the remaining 50% owned jointly by Thomas Christopher Howe Fleming, Paul Kenneth Foster, Anthony Andrew Peter Van den Brink and Karl Joseph Van den Brink.
11. Brinks' core business is contract growing broiler chickens and processing and selling chicken products. The company is not fully vertically-integrated, with its activities confined largely to primary and secondary processing, and supply of chicken products. Brinks does not have any poultry breeding operations, hatcheries or further processing facilities, and has only a limited involvement in the manufacture of chicken smallgoods products. Brinks has processing plants in Karaka (South Auckland), Tuakau (South Auckland) and Rolleston (near Christchurch).
12. In 2007, Brinks, the third largest processor in New Zealand, processed around [ ] million chickens – [ ] million birds in the North Island and [ ] million birds in the South Island. In 2007, the company processed [ ].
13. Brinks supplies branded and unbranded chicken to supermarkets and, in particular, restaurants, cafés and small retailers on a national basis. Currently, it does not supply QSR customers.

### **OTHER PARTIES**

#### **Inghams**

14. Inghams Enterprises (NZ) Pty Limited (Inghams) is a wholly owned subsidiary of Inghams Enterprises Pty Limited, an Australian-based operator. Inghams is the largest producer of chicken in Australia. In New Zealand, Inghams is a fully vertically-integrated poultry company with its own breeding operations, hatcheries, feedmills, contract growing and processing operations.
15. Inghams entered the New Zealand market in 1990 through the acquisition of Harvey Farms (in receivership). Inghams has one primary processing plant in New Zealand which is situated at Waitoa, near Te Aroha. It also has further processing facilities at Cambridge in the Waikato and Auckland.
16. Inghams purchases day-old parent breeders from Bromley Park Hatcheries and then breeds its own DOCs from this parent stock at its hatchery facilities. These DOCs are produced solely for Ingham's own requirements. [ ].
17. Inghams is the second largest chicken processor in New Zealand with an annual kill of around [ ] million birds. Inghams utilises [ ]% of its processing capacity, and supplies supermarkets, food service providers and QSRS.

#### **Turks**

18. Turks Poultry Limited (Turks) is a partially vertically-integrated poultry company. The company grows broiler chickens and processes and sells primarily whole chickens and further prepared chicken products. Turks also produces a small amount of further processed chicken products such as smoked chicken. Turks has its own feedmill operations, and also rears its own chickens (in combination with contract growers). Turks' operations are based in Foxton.

19. The majority of chickens processed by Turks are free range and cornfed, as opposed to the majority of Tegel's chickens which are barn raised and conventionally fed, and all those processed by Brinks and Inghams.
20. Turks supplies some chicken products to Foodstuffs Auckland and to Foodstuffs Wellington. In 2007, Turks processed approximately [ ] million chickens. In 2007, Turks utilised around [ ]% of its processing plant's capacity. [ ]

### **Spring Chicken**

21. Spring Chicken Limited (formerly Country Pride Chicken Limited) (Spring Chicken) started poultry processing in June 2008 as a fully vertically integrated operator. Spring Chicken was formed by a number of contracted chicken growers who previously grew for Brinks and Tegel. Spring Chicken has a processing plant at Waiuku, south of Auckland. The company also had its own breeding operations, hatcheries, and feedmill operations. However, after experiencing initial operational and financial difficulties, the company has been restructured which will result in a group of investors and Bromley Park Hatcheries becoming the principal shareholders in the company. The company no longer intends to operate its own breeding and hatchery operations.

### **Heuvels**

22. Ferngate Limited, a company based in Invercargill, produces certified, organic, free range chicken products under the Heuvels brand. Its chicken products have a retail price which is approximately three to four times higher than that of comparable non-organic chicken products by processors such as Tegel, Brinks, Turks, and Inghams. Currently, Heuvels processes around [ ] birds per annum in a plant previously operated by Brinks.

### **Aviagen**

23. Aviagen New Zealand Limited (Aviagen), which is part of the Aviagen group, is involved in the importation and initial quarantine hatching of breeding stock. It holds the intellectual property rights in New Zealand for the Ross bird. In 2007, it acquired from Tegel the primary breeding operations for the Ross bird in New Zealand. Subsequently, [ ]. Aviagen has advised the Commission that it will also supply breeding stock to other parties, if requested.
24. Aviagen mainly supplies Tegel. [ ]

### **Bromley Park Hatcheries**

25. Bromley Park Hatcheries Ltd<sup>3</sup> (Bromley Park) is involved in all stages of the breeding and hatching of poultry in New Zealand. Bromley Park has the exclusive distribution rights in New Zealand for the Cobb bird, which it imports from the USA.<sup>4</sup> Currently, Bromley Park is involved in the importation and initial quarantine hatching to produce breeding stock; the supply of parent breeding stock to Inghams for use in that company's breeding operations; the supply of day-old broiler chicks to Brinks, Turks and Heuvels; and the supply of day-old layer chicks to table egg producers throughout the country. Recently, Bromley Park agreed to purchase a [ ]% shareholding in Spring Chicken, and to supply that company with DOCs. Bromley Park has breeding operations in both the North and South Islands.

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<sup>3</sup> This includes a number of related companies.

<sup>4</sup> Tyson Foods is the owner of the intellectual property rights for the Cobb breed.

26. In 2007, Brinks accounted for approximately [ ]% of Bromley Park's total sales and [ ]% in the South Island. [ ].

### **PIANZ**

27. The Poultry Industry Association of New Zealand (PIANZ) represents the interests of the poultry processing and breeding companies. PIANZ acts as a conduit between the industry and Government regulatory bodies and canvasses issues such as animal welfare, the use of antibiotics in chicken production, avian influenza, campylobacter and salmonella, exports and imports. In addition, PIANZ coordinates industry training and collects and circulates technical information and industry statistics.

### **NZFSA**

28. The New Zealand Food and Safety Authority (NZFSA) is the controlling authority for imports of food and sets the policies, criteria and procedures to monitor the safety of imported food for human consumption.

### **MAF Biosecurity New Zealand**

29. MAF Biosecurity NZ is a division of the Ministry of Agriculture and Forestry (MAF) which is responsible for controlling New Zealand's biosecurity system. 'Biosecurity' is the protection of the economy, environment and people's health from the harm arising from pests and diseases.

### **Major Customers of Chicken Suppliers**

30. There are three major customer categories that purchase chicken products; supermarkets, food service and QSRs.

#### *Supermarkets*

31. Supermarkets are the largest customer category, accounting for [ ]% of primary and secondary processed chicken product sales. The two major customers in this category are:
- Progressive Enterprises Limited (Progressive), which operates the Foodtown, Woolworths and Countdown banners (and Fresh Choice and Supervalu – mainly in the South Island); and
  - the three regional Foodstuffs co-operatives, which operate the PAK'nSAVE, New World and Four Square banners. Two of the Foodstuffs co-operatives operate in the North Island (Foodstuffs Auckland in the upper half of the North Island and Foodstuffs Wellington in the lower half) and the other operates in the South Island (Foodstuffs SI).
32. Supermarkets purchase a wide range of branded and unbranded chicken products, including whole bulk dressed chickens, packaged whole birds and the full range of cut pieces and further processed chicken products and chicken smallgoods.

#### *Food Service Providers*

33. The food service category, accounts for [ ]% of primary and secondary processed chicken sales, and comprises the following customers:

- further preparers and smallgoods manufacturers such as Santa Rosa Marketing Limited (Santa Rosa) and Sam's Fukuyama Food Services Ltd (Sam's), purchase fresh whole dressed birds in bulk from primary processors and carry out further processing into a variety of value added products;
- distributors of a wide range of chilled and frozen food products, such as Crean (a division of Bidvest (New Zealand) Ltd) and Countrywide Distributors (NZ) Limited (Countrywide); and
- retailers, such as Westmeat and Raeward Fresh, trade name for Hellaby Meats (South Island) Limited.

#### *Quick Service Restaurants (QSR)*

34. QSR customers, which account for [ ]% of primary and secondary processed chicken sales, are large fast food restaurants, which are distinguished by their size, strict product specifications and service level requirements. These include KFC, McDonalds, Burger King and Subway. QSR customers are typically large volume purchasers of particular cuts of a range of primary, secondary and further processed/smallgoods chicken products.

## **INDUSTRY BACKGROUND**

### **Overview**

35. The proposed acquisition relates to the production of broiler chickens.
36. There are three main stages of production in the broiler chicken industry:
- upstream breeding stock;
  - growing broiler chickens; and
  - processing into chicken.
37. A further related stage is the production of broiler feed.

### **Breeding**

38. The breeding process begins when fertile hatching eggs are imported by poultry breeding companies every one to two years under strict quarantine requirements. Currently there are two breeding companies in New Zealand which are importing breeding stock: Aviagen and Bromley Park.
39. Each of these primary breeding companies is associated with an international breeding business which owns the Intellectual Property Right (IPR) of a particular breed. Typically, the IPR holder sells breeding stock to a breeding company on an exclusive basis for each country.
40. Chicken production in New Zealand is based on two breeds of bird:
- the Ross bird from the United Kingdom; and
  - the Cobb bird from the United States of America.
41. The importation of hatching eggs is governed by strict quarantine requirements in the form of import health standards.<sup>5</sup> Only eggs that comply with the import health standards can be brought into New Zealand.<sup>6</sup>

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<sup>5</sup> Import health standards are issued in accordance with s 22 of the Biosecurity Act 1993.



42. The imported hatching eggs are transported by air in sealed containers directly to company-owned quarantine farms and hatcheries under MAF supervision. After approximately three weeks in specifically–designed incubators, the chicks hatch to produce the great grandparent (GGP) generation. The total period that the birds are held in quarantine is approximately nine weeks. The reason for importing birds at the GGP level is to develop sufficient volumes of breeding stock at the next generation by crossing selected lines to produce grandparent (GP) stock.
43. Following health and biosecurity clearance, the birds are transferred to GGP breeding farms. The GGP stock is used to breed the next generation which is the GP stock. The GP stock is then used to produce the parent stock.
44. The parent stock in turn produces eggs that will hatch to become broiler chickens grown for meat production. On average, a parent breeding flock will be kept for about 60 weeks and produce about 140 hatching eggs per female bird.
45. Typically, the offspring of the parent stock are supplied to poultry processors as DOCs. The hatching operation takes 21 days and the chicks are then transported to broiler grower farms. Hatcheries and processing plants are generally located in close proximity to each other.
46. The entry requirements into the production of breeding stock include establishing a quarantine facility, a breeding farm and hatcheries. Bromley Park estimates that it would cost about [ ] to become a fully vertically integrated upstream operation to a scale sufficient to produce enough parent chickens to supply half of the New Zealand DOC market.
47. There is a long lead time required from the time of importation of the GGPs to the hatching of DOCs and reaching full production. Bromley Park submits that there is a minimum of two years from the importation of GGPs to the hatching of DOCs, and three years until full production is reached.

### **Growing**

48. Processors and growers enter into contracts. Under these contracts, processors supply contract growers with DOCs to be reared according to detailed specifications. Processors also control the feed and genetic material for the breeding of DOCs. The processor also determines:
  - the weight of the DOCs supplied to growers;
  - the number of DOCs supplied to growers; and
  - the number of growing cycles per annum.
49. Processors retain ownership of the birds. Contract growers provide land, labour and buildings.
50. The DOCs are grown until they reach the ideal weight for slaughter, which is generally around four to six weeks. Chickens are then transported directly from the growing farm to primary processing plants.

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<sup>6</sup> Currently, there are only four countries in the world from which chicken hatching eggs can be imported into New Zealand, and to which import health standards apply. Those countries are Australia, the UK, the USA and Canada. Imports of eggs from the USA and Canada are covered by a common import health standard.

## Processing of broiler chickens

51. The processing of broiler chickens may involve up to four production stages:
- primary processing, which involves the killing and dressing (scalding, defeathering and evisceration) of the bird to produce whole dressed birds. Primary processed whole birds are sold fresh or frozen to retailers, food service providers, further preparers;
  - secondary processing, which entails cutting up a whole chicken into portions (i.e. legs, breasts, wings etc), and may also include deboning. Secondary processed chicken may also be sold fresh or frozen;
  - further processing, which involves a wide variety of value-add stages using automated facilities to produce specialised chicken products (e.g. nuggets and formed and coated chicken patties), as well as an increasing range of ready-to-eat pre-cooked products such as Chicken Kiev; and
  - smallgoods manufacture, which involves additional processing to create chilled, ready-to-eat products, such as smoked chicken, sliceable roasts, sausages and bacon.

## Broiler Feed

52. Broiler feed, which consists of specially formulated ingredients, forms an important component in the production of chicken. It accounts for around 60-70% of the total cost of chicken production and the quality of the feed is an important determinant in the rate of growth of broiler chickens.

## Regulatory Requirements

53. Chicken processors are required to adhere to a range of measures under various legislation and related regulations and codes. Under the Animal Products Act 1999, all primary poultry processors (i.e., those that slaughter and dress poultry), are required to have approved Risk Management Programmes (RMPs) in place. RMPs are designed to identify, control, manage, eliminate or minimise hazard and other risk factors so the resulting product is fit for its intended use. For poultry, these cover a range of processes, including how the processor manages food safety, pest control and product testing. Birds must be tested for generic Salmonella, E. coli and Campylobacter, with the results having to be reported to the NZFSA.
54. A primary processor is also required to have its RMP audited by a verification process (administered by NZFSA) usually on a three monthly basis although the frequency of the visits depends on the performance of the business concerned.
55. If secondary processing is undertaken, then it is possible for a primary processor to apply for an extension to an existing RMP. Otherwise, it is necessary to comply with the Food Act 1981, which has a different set of requirements to that of the Animal Products Act.

## MARKET DEFINITION

### Introduction

56. The Act defines a market as:

“... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.”<sup>7</sup>

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<sup>7</sup> S 3(1A) of the Commerce Act 1986.

57. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose at least a small yet significant and non-transitory increase in price (a SSNIP), assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increases in price that is sustained for a period of one year.
58. The Commission defines relevant markets in terms of five characteristics or dimensions:
- the goods or services supplied and purchased (the product dimension);
  - the level in the production or distribution chain (the functional level);
  - the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
  - the temporal dimension of the market, if relevant (the timeframe); and
  - the customer dimension of the market.
59. The Commission first examines the product dimension, followed by the functional, customer and geographic dimensions of the market.

## **Product Dimension**

### *Introduction*

60. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market. The degree of demand-side substitutability is influenced by the extent of product differentiation.
61. The Applicant submitted that while chicken products might form a discrete market from other forms of animal protein, there is a significant degree of substitutability between chicken, beef, lamb, pork, fish and other protein meal alternatives.

### *Substitutability Between Chicken Products and Other Forms of Animal Protein*

62. Animal proteins include poultry, lamb, mutton, beef and veal, and pork. The relevant test to determine whether chicken is a distinct market from other animal proteins is whether switching between meat products occurs in response to a change in relative prices.
63. Industry participants advised the Commission that different acquirers exhibit varying degrees of price sensitivity and switching. For example, consumers who purchase chicken products from a supermarket are likely to respond differently to diners in a restaurant when faced with an increase in the price of chicken.
64. Nigel Boswell, Managing Director of Crean, one of New Zealand's largest food service providers, stated that typically, restaurants must have a chicken dish on their menu. Mr Boswell advised the Commission that, in 2007, the prices it paid for chicken increased by up to 28%. In response to these price increases, Crean's customers, who are primarily in the hospitality and catering industry, tend to switch to less costly cuts within the same type of meat.

65. [ ], Chief Executive Officer of [ ], a food service provider, stated that chicken products were subject to substantial price increases in 2007. He stated that:
- there was a bit of moaning and whinging but everybody kept on buying {chicken}.<sup>8</sup>
66. Brent Thomas, Director of Raeward Fresh, a South Island based food service provider, also advised the Commission that between October 2007 and May 2008, retail prices of chicken in the company's stores rose by 8%, while over the same period, lamb prices dropped by 25%. Volume sales of both products altered only marginally.
67. In summary, the qualitative evidence presented above suggests that significant increases in the price of chicken products do not generally lead to significant decreases in the level of consumption of chicken products.

### Quantitative Analysis

68. The Applicant submitted a 1996 [ ] study, which estimated both own- and cross- price elasticities. Own price elasticity measures the change of consumer demand for a given product as a result of the change in price of that product, while the cross-price elasticities of a product measures the effect on the change in demand of the product as a result of a change in the prices of other related products.
69. The [ ] study estimated an own price elasticity of [ ] for chicken, indicating that the demand for chicken will decrease by around [ ] in response to a [ ] increase in the price of chicken.
70. A high level analysis carried out by the Commission, using supermarket scanner data provided by Tegel suggests that the price of chicken products increased, on average, by 40% between June 2006 and June 2008. Over the same period, volume sales of these products decreased by 17%. Demand for these products therefore appears to be relatively inelastic with regard to its own price, i.e. the change in demand would be proportionately smaller than the change in price. The Commission notes, however, that this high-level analysis does not take into account other factors, such as consumer preference and income that contribute to level of demand for chicken products.
71. The [ ] report also estimated a cross price elasticity with [ ], indicating that the volume of [ ] in response to a [ ] increase in the price of chicken. This might suggest that [ ] imposes some degree of constraint. However, this constraint is not sufficient in itself to deter a hypothetical monopolist to raise its prices by more than 5%. Consequently, the Commission is of the view that [ ] should not be included in the same market as chicken.
72. In addition, the Commission carried out a stationarity analysis to assess whether prices of different products move together over time. The theory underlying this analysis is that if two products are in the same market, then the price of each will constrain the other, so the prices of these products should move together over time. If two products' prices move together over time, the relative price of these products should be constant over time.
73. The analysis, which was based on the food price indices for poultry, beef, lamb and pork, from January 1989 to January 2008, suggests that prices of chicken relative to beef, pork and lamb, respectively, do not tend to be constant over time.<sup>9</sup> This evidence

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<sup>8</sup> [ ]

<sup>9</sup> Econometric tests of stationary confirm this finding.

is consistent with chicken products being in separate product markets from beef, pork and lamb.

74. The Applicant also provided quantitative analysis conducted by economic consultancy NERA that addresses the question of product market definition. While showing some effects of the price of other forms of animal protein on the consumption of poultry, NERA concludes that the results presented are not sufficient to conclude that other animal protein compete in the same market.
75. The Commission notes that the ACCC, the European Commission, and the South African Competition Commission have all previously defined a discrete market for chicken. In particular, the EC estimated own price elasticities for pork (-0.3), beef (-0.3) and poultry (-0.2), and established that the cross price elasticities were smaller than 0.3.<sup>10</sup>
76. The Commission acknowledges that switching between different forms of animal protein does occur. However, based on the qualitative evidence presented above, switching appears to be limited. Further, quantitative analyses carried out by the Commission and the Applicant confirm that chicken products are likely to be in separate product markets from other forms of animal protein.

#### *Substitutability Between Fresh and Frozen Chicken Products*

77. Tegel submitted that for the purposes of this Application the Commission should consider fresh and frozen chicken to be in the same product market. Frozen chicken is a by-product of the processing of fresh chickens. If a chicken processor has been unable to forward-sell all its fresh chicken products then it can freeze them, which prolongs the shelf life of the chicken but at the same time reduces the price. All the main players supply both fresh and frozen chicken.
78. From a demand-side perspective, price and perceived quality advantages differentiate fresh and frozen chickens. For example, a benefit of fresh chicken is that it is ready to cook. On the other hand, frozen chicken is typically cheaper and can be stored for extended periods.
79. From a supply-side perspective, the Commission notes that all chicken processors produce both fresh and frozen products, suggesting a significant degree of supply-side substitutability. In 2007, the sale of fresh chicken represented around 80% of total chicken sales in New Zealand.
80. To this extent, the Commission considers that fresh and frozen chicken products fall within the same product market.

#### *Primary v. Secondary Processing*

81. The Applicant submitted that the best way to assess any impact of the proposed acquisition is at the primary processing level (the market for the wholesale supply of whole dressed chickens) and the secondary processing level. All chicken processors produce primary and secondary processed chicken products with the secondary processing occurring seamlessly at the end of the primary production line.
82. On the demand-side, there is a convenience factor in buying chicken that has already been cut up or de-boned; however, there is a price advantage in buying a whole bird and cutting it up oneself. The Commission considers that, since all chicken processors

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<sup>10</sup> Case numbers: M.4257, M.2662, M.3401, M. 3337 & M.3522

produce both primary and secondary processed chicken, these products are substitutable from a supply-side perspective.

83. To this extent, the Commission considers that whole birds (primary processed) and chicken pieces (secondary processed) are in the same market.

*Primary/Secondary and Further Processed /Smallgoods*

84. On the supply-side, there is limited degree of substitutability between primary/secondary processed goods and further processed products/smallgoods. The Commission considers that further processing can only be done efficiently by automated and mechanised lines, requiring investment in plant and physical space.
85. On the demand side, primary/secondary processed and further processed chicken products/smallgoods appear to have significantly different product characteristics. For example, such products can be differentiated on the basis of price (for instance the cost of one kilo of primary/secondary processed chicken is likely to be far less than the price of a kilo of Chicken Kiev because of the value added to the Chicken Kiev). Further, the Commission notes that branding is more prevalent and more important in respect of the sale of further processed and smallgoods products.
86. To this extent, the Commission considers that further processed chicken products are in a discrete market.

*Conclusion on Product Dimensions*

87. The Commission concludes that chicken is in a discrete product market from other forms of animal protein. Primary and secondary processed chicken products are sufficiently similar to be included in the same product market, as are fresh and frozen chicken products. However, because of differences in product characteristics and price, the Commission considers that further processed and smallgoods products form a discrete market.
88. Therefore, the Commission considers that the relevant product market in this instance is for primary/secondary processed chicken, including both fresh and frozen products.
89. As no aggregation would occur in respect of further processed chicken and smallgoods, the Commission does not intend to discuss these product markets further.

**Functional Dimensions**

90. The distribution and sale of a product or service typically occurs through a series of functional levels, conventionally arranged vertically in descending order. In assessing the appropriate functional levels, the Commission considers factors, such as observed structures of seller-buyer relationships and the possible presence of economies of scope between adjacent functional levels, such that vertical integration might be efficient. Generally, the Commission identifies separate relevant markets at each functional level.
91. In assessing the current Application, the Commission has considered the main stages of production in the chicken processing industry. As outlined the Industry Background, these stages involve the upstream breeding of stock; the supply of DOCs; the growing of broiler chickens the manufacture and supply of chicken feed; and the downstream supply of processed chickens.
92. All of these activities involve very different plant, equipment and knowledge and are therefore non-substitutable from a supply-side perspective. Likewise, the outputs from

each of the stages are very different and therefore non-substitutable from a demand-side perspective.

93. Given the above considerations, the Commission considers that for the purpose of assessing the competitive effect of the proposed acquisition, the relevant functional dimensions are those for the:
- rearing and supply of chicken breeding stock;
  - rearing and supply of DOCs;
  - provision of chicken growing services;
  - manufacture and supply of chicken feed; and
  - wholesale supply of primary and secondary processed chicken products.
94. The Commission intends to consider the entire supply chain of chicken products because of the significant amounts of vertical integration in the industry. Further, aggregation at the downstream processing stage could have market power ramification upstream.

### **Customer Dimension**

95. The Commission examines the extent of, and potential for, suppliers to discriminate between different customer types within identified relevant markets. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission considers whether it would be appropriate to define additional markets based on particular uses for a good or services, particular groups of buyers, or buyers in particular geographic areas that are captive to those products and unable to switch in the face of a price increase.
96. The Applicant submitted that the acquirers of chicken products fall into three groups defined by reference to their buying behaviour:
- large retail (supermarkets and large butchery chains);
  - QSRs; and
  - food service and small retail.

### *Supermarkets*

97. Supermarkets form the largest customer category which account for around [ ]% of total primary and secondary processed chicken sales. The key chicken products supplied to supermarkets include the following branded and unbranded chicken products:
- primary processed whole dressed chickens;
  - a full range of cut up pieces; and
  - a full range of boneless pieces.
98. The Applicant submitted that the main customers include: Progressive Enterprises, Foodstuffs, and Warehouse Extra<sup>11</sup>, and the largest butchery chain, the Mad Butcher. These customers buy in bulk via centralised purchasing agreements.

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<sup>11</sup> At the time of the Application the Warehouse Extra was a customer but with the demise of the Warehouse Extra, it is no longer, or will not be for much longer.

99. The Commission notes that the Mad Butcher operates a nationwide chain of 34 butchery stores compared to Progressive which operates 150 supermarkets nationwide and Foodstuffs operating 176 supermarkets nationwide. The Mad Butcher's volume requirements are much smaller than supermarkets'. For instance, in 2007, the Mad Butcher purchased around \$[ ] million worth of primary and secondary processed chicken products, compared to around \$[ ] million worth of comparable products by each of Progressive and Foodstuffs. From a consumer's perspective, supermarkets are a one-stop shopping destination. In contrast, the Mad Butcher is a one-stop shop for meat. For these reasons, the Commission considers that the Mad Butcher and other non-supermarket retailers are likely to be more comparable with food service providers than with supermarkets.
100. Progressive negotiates prices and promotion plans for its chicken products centrally at its head office by letting tenders for its supply contract on a [ ] basis. Although prices are determined as part of the tender process, there is also provision for [ ]
101. In order to participate in this tender process, a processor must be an approved supplier; presently, these are Tegel, Brinks, and Inghams.<sup>12</sup> Processors may win all or part of these supply contracts e.g. supply some products only, or some regions only (or a combination of the two).
102. Foodstuffs' supermarkets have the option of purchasing chicken products through a central buying scheme. Alternatively, individual supermarkets can purchase these products directly from processors. The majority of prices and promotion plans are negotiated at head office with smaller promotions being negotiated at individual store level.
103. Because of the volumes that supermarkets demand, prices to them tend to be lower than those charged to food service customers.

#### *QSRs*

104. QSR customers are fast food restaurant chains that are distinguished by their size and their strict product specifications and service level requirements. QSRs require suppliers to meet very precise specifications, in terms of the shape, size and cut of the product as well as service levels, plant approvals and other quality and delivery requirements. Their product requirements typically relate to the need to ensure uniformity and standardisation of product throughout the chain.
105. QSRs demand a range of primary, secondary and further processed/smallgoods chicken products. For instance, KFC has a requirement for mainly fresh secondary processed chicken and some further processed product. KFC demands that the products it purchases be of a standardised size. Most other QSRs, such as McDonalds and Burger King tend to purchase further processed product, such as partially or fully cooked products (e.g. nuggets, patties and coated products).
106. In 2007, the size of the New Zealand QSR market was \$[ ] million ([ ]%) for primary and secondary processed products. KFC acquires [ ]% of products and represents the bulk of sales in this market.

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<sup>12</sup> In order to become an approved supplier, a processor has to meet quality standards set out by Progressive and agree to their required terms and conditions of supply and distribution.



107. In contrast to supermarkets and food service customers, KFC, which is by far the largest QSR customer, lets a tender for the supply of its chicken. The last time this contract was let was in [ ]
108. In respect of the KFC contract, because of the very large volumes negotiated at the time of letting the contract, prices to this company are also lower than those charged to food service customers. In respect of the other QSR customers, although the volumes of primary and secondary processed chicken are lower than those acquired by KFC, given that these customers also purchase high volumes of further processed chicken products, they are able to negotiate favourable prices.

#### *Food Service Customers*

109. The food service category comprises a wide range of customers which account for [ ]% of total primary and secondary processed chicken sales. Customers in this market are supplied with unbranded primary and secondary processed fresh and frozen chicken products.
110. Customers in this market include:
- further preparers and smallgoods manufacturers who purchase fresh whole dressed birds in bulk from the primary processors and carry out processing into a variety of value-added products, such as Santa Rosa and Sam's;
  - distributors of a wide range of food products, including chicken, such as Gilmours and Crean; and
  - retailers, such as The Mad Butcher and Raeward Fresh.
111. In general, these customers order on a daily or weekly basis, and there are few fixed contracts. The processors typically provide price lists to food services customers. The volume requirements of these customers are much less compared to supermarkets or QSRs. In value terms, these customers demand between \$[ ] to \$[ ] per annum.
112. Food service customers tend to be fragmented. For example, in 2007, the Mad Butcher purchased around \$[ ] million worth of primary and secondary processed chicken products, Sam's \$[ ] million, and Westmeat \$[ ] million. This contrasts with Progressive which purchased around \$[ ] million worth of comparable products in 2007.

#### *Conclusion on Customer Dimension*

113. The Commission considers that because of the large volumes of chicken products that supermarkets require, the very precise specifications of products required by QSRs, and the relative fragmentation of food service customers, there are likely to be three distinct customer types. Accordingly, the Commission considers that the competitive effects of the proposed acquisition are best assessed by considering the following as discrete customer groups:
- supermarkets;
  - QSRs; and
  - food service customers.

### **Geographic Dimension**

114. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

#### *Chicken Breeding Stock*

115. The Applicant submitted that this market is national in scope because Aviagen regularly transport parent breeders to Tegel in the South Island.

116. Bromley Park and Aviagen both advised the Commission that they transport breeding stock throughout New Zealand. For example, Aviagen has its own air cargo plane for the transportation of breeding stock to the South Island from its breeding plants based in New Plymouth. Bromley Park also transports breeding stock nationally, including to its hatcheries in the South Island.

117. To this extent, the Commission considers that this market is likely to be national in scope.

#### *DOCs*

118. The Applicant is of the view that this market is national in scope. This is because it considers that it is both feasible and economically viable to transport DOCs between the North and South Islands across islands, either by air or surface transport.

119. The Commission notes that Tegel has breeding operations proximate to each of its processing plants and that Brinks takes its DOC supply from each of Bromley Park's North and South Island breeding operations.

120. Bromley Park, the only non-vertically integrated supplier of DOCs informed the Commission that in contrast to the breeder DOCs, it is neither feasible nor economically viable to transport DOCs between the North and South Islands because the birds suffer from stress when transported thereby reducing the weight gain of the chicken and feed conversion. As such, mortality is increased.

121. Turks advised the Commission that the longer the time of transportation of DOCs, the higher the likelihood of welfare issues. For example, Turks receives DOCs from Bromley Park which are transported six hours to its Foxton processing plant. Turks stated that for it this transportation results in animal welfare problems. [ ]

122. Accordingly, the Commission is of the view that the market for the supply of DOCs is likely to be regional in scope, i.e. there are a number of geographic markets within the North and South Island.

#### *Chicken Growing Services*

123. The Applicant submitted that it is necessary for growing facilities to be located in close proximity to processing plants. This is because of animal welfare concerns, meaning live fully-grown birds cannot be transported for long periods. Accordingly, most contract broiler growers tend to be located within approximately two hours drive from the primary processing plant, but it is possible for birds to be transported to the place of slaughter (by road) for up to four to six hours or longer.

124. Growers interviewed by the Commission agreed with Tegel's submission advising that they were only able to grow for processors within their particular region. The

Commission therefore considers that the markets for the provision of chicken growing services are likely to be regional in scope.

#### *Chicken Feed*

125. Tegel submitted that because of the weight and bulk of feed, it is not economic to transport it over long distances. Feed producers such as Inghams, Feedco, and PCL Feeds, a producer of broiler feed, all agreed with Tegel's submission. In addition, the Commission notes that each of the chicken processors in New Zealand, except Brinks, manufactures its own feed which it does in close proximity to its processing plant. Brinks takes its feed from Inghams in the North Island and Feedco in the South Island. Each of these feed operations is in close proximity to Brinks' plants. Consequently, the Commission is of the view that the chicken feed markets are likely to be regional in extent.

#### *Supply of Primary and Secondary Processed Chicken - Supermarkets and Food Services Customers*

126. Tegel submitted that the market for the processing and supply of primary and secondary processed chicken products is a national one. This is because the products are supplied and sold on a national basis and all the leading industry players actively sell their products in both the North and South Islands. In addition, Tegel contended that the cost of transporting chicken products from the North to the South Island is small relative to the selling price of chicken products.

127. Further, Tegel submitted that in the Commission's investigation report of 08 July 1996 concerning Tegel and Pacifica Poultry Ltd, it determined that there was a national market for the processing and wholesale distribution of chicken meat products (both fresh and frozen). In addition it said that a narrower geographic distinction would be even less plausible today. This is because due to technology advances, the shelf life of fresh chicken meat has increased and is now between eight and ten days depending on the cut of the chicken. Further, chicken can be easily transported to the South Island within 24 hours. Tegel advised that it, Inghams and Brinks transport products to the South Island on a daily basis, especially Inghams which only has a North Island processing facility.

128. The Commission considers that the following factors are relevant to its consideration of the geographic scope of the market:

- transport costs;
- volumes transported from the North to the South Island;
- reliability of supply; and
- shelf life.

#### Transport Costs

129. Tegel estimated the cost of transporting chicken products is small compared to the cost of the products themselves. Tegel advised the Commission that it considered freight costs from the North to the South Island would make up approximately [ ] of the net selling price of chicken products.

130. An internal paper to Tegel's board [ ] notes that:

- [ ]
131. [ ]
- ]
132. The Commission calculated that the cost of transporting fresh chicken products from the North to the South Island depends on the volume of product shipped. Shipping a single carton costs around \$[ ] per kg. This compares to \$[ ] per kg for a pallet and \$[ ] per kg for a full truck load.
133. Taking a conservative approach and using the wholesale list prices of fresh chicken products that South Island food service customers might be quoted, the Commission notes that the price varies depending on the cut of meat. For example, breast fillets are priced at \$[ ] per kg, whole birds at around \$[ ] per kg and wings, thighs and drums at \$[ ] per kg.
134. Therefore, the cost of transporting fresh chicken products from the North to the South Island accounts for approximately 2% to 6% of the wholesale list price of a kg of breast fillet, 5% to 14% of the price of a whole dressed chicken, and 6% to 18% of the price of wings, thighs and drums.
135. Tegel submitted that as Inghams operates a single plant to produce its entire primary and secondary processed requirements, it is necessarily more efficient than any other participant in the industry. Further, Tegel contended that Inghams' efficiencies are such that the additional costs of transporting products to the South Island would be more than offset.
136. The Commission considers that operating a single processing plant might have advantages in terms of efficiency and that these efficiencies may offset transport costs. However, there may be other factors that disadvantage Inghams in supplying chicken products from the North to the South Island such as transport costs, reliability of supply, and shelf life issues.

#### Volumes Transported from the North Island to the South Island

137. The Commission notes that by far the majority of fresh primary and secondary processed chicken products supplied in the South Island have also been processed in the South Island.
138. Turks and Spring Chicken have no processing facilities in the South Island and do not supply fresh chicken products to any South Island based customers on a regular basis. Periodically, Turks and Spring Chicken have supplied negligible amounts of chicken products to the South Island; however, this has been on a very sporadic basis.
139. Inghams is the only current supplier of primary and secondary processed chicken products to South Island customers that does not have processing facilities in that Island. As a result, Inghams transports by road from its North Island facility the chicken products that it supplies in the South Island.
140. Table 1 and Table 2 show the proportion of each supplier's sales that it made to supermarkets and food service customers in each of the North and South Islands.

**Table 1: Proportion of Respective Processors' Sales to Supermarket Customers Made in the North and South Island (using 2007 data)**

Participant	North Island		South Island	
	Value (NZ\$m)	Proportion (%)	Value (NZ\$m)	Proportion (%)
Tegel	[ ]	[ ]	[ ]	[ ]
Brinks	[ ]	[ ]	[ ]	[ ]
Inghams	[ ]	[ ]	[ ]	[ ]

**Table 2: Proportion of Respective Processors' Sales to Food Service Customers Made in the North and South Island (using 2007 data)**

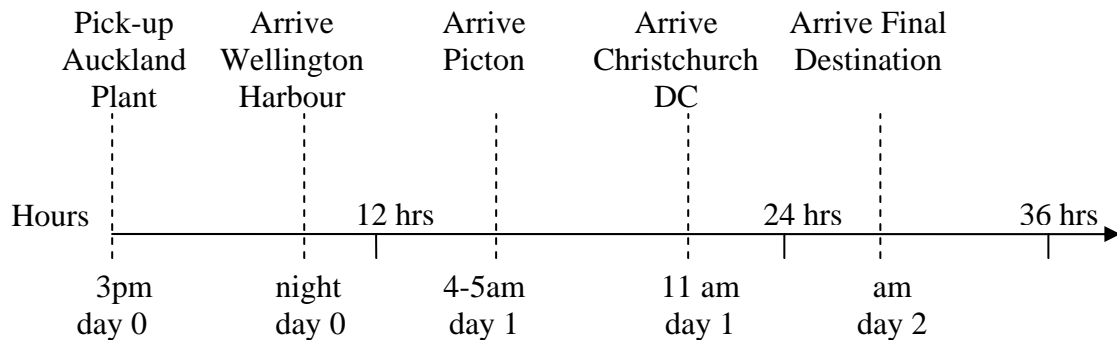
Participant	North Island		South Island	
	Value (NZ\$m)	Proportion (%)	Value (NZ\$m)	Proportion (%)
Tegel	[ ]	[ ]	[ ]	[ ]
Brinks	[ ]	[ ]	[ ]	[ ]
Inghams	[ ]	[ ]	[ ]	[ ]

141. These tables show that in 2007, compared to Tegel and Brinks, a relatively small proportion of Inghams' overall sales were made to South Island customers. The Commission considers that there could be several reasons for this: for example, either Inghams has not focused on the South Island, or there are difficulties in it supplying South Island customers. This might also be the case for Turks and Spring Chicken.
142. The Commission is aware that Brinks and Tegel ship some fresh products from their North Island processing plants to their South Island processing plants for further processing and distribution in the South Island on a regular basis. However, these volumes do not appear to be substantial. In the first quarter of 2008, Tegel supplied approximately [ ]% of its total South Island sales with chicken processed in the North Island. During the same period, Brinks sourced approximately [ ]% of its South Island sales from the North Island.
143. Further, Tegel advised the Commission that after a fire destroyed part of its Christchurch processing facility in 2007, the company sourced [ ]% of its South Island sales from its North Island processing plant. During this period, Tegel transported chicken products from the North Island to its Christchurch plant, from where it redistributed the products to its South Island-based customers. The Commission notes that this was an atypical situation and that Tegel's reliability of supply in the South Island dropped substantially over this time. Tegel did not continue to ship comparable volumes from the North Island to the South Island once the factory was rebuilt.

#### Reliability of Supply

144. Supplying South Island based customers from a North Island processing plant involves crossing the Cook Strait. Tegel acknowledged that weather conditions in the Cook Strait can disrupt ferry crossings from time to time. However, Tegel contended that the actual incidence of adverse weather in the Cook Strait giving rise to sailing delays is small and in most cases, sailings are only delayed for between a few hours and half a day. Tegel estimated that significant disruptions only occur six to eight times per year.

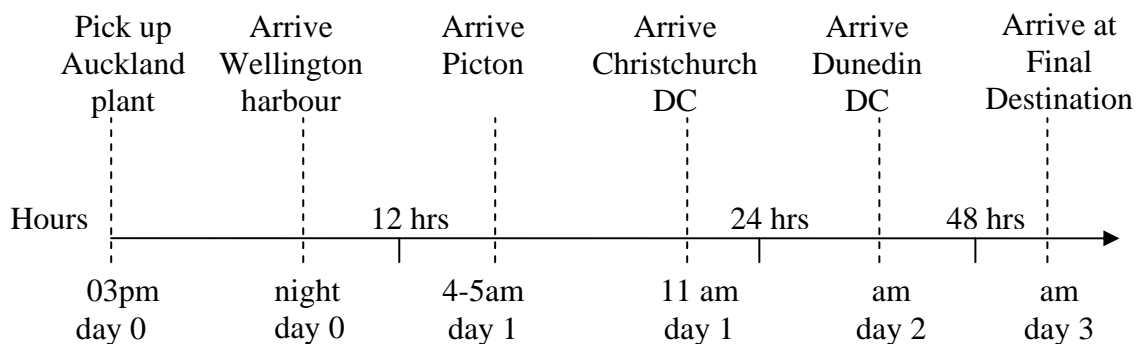
145. Despite Tegel's contention, an internal paper to Tegel's board [ ] discusses the security of supply when supplying South Island based customers from its North Island processing facilities. The paper notes that:
- [ ]
146. Inghams submitted that, in respect of security of supply to South Island based customers, it had over-promised and under-delivered in the past. Michael Rozen, General Manager of Inghams said that:
- we've traditionally found it very hard to break into the retail market there. [ ] Tegel seem to have a significant advantage in that camp
147. Foodstuffs SI and Progressive informed the Commission that security of supply is important to them and that the shipping of fresh chicken products on a daily basis across the Cook Strait raises concerns for them. Foodstuffs SI stated that [ ].
148. Progressive stated that Inghams supplied some of its South Island stores with fresh chicken products in 2007. However, Progressive said that Inghams had [ ] Peter Smith, Managing Director of Progressive, said that Inghams [ ].
149. Typically, supermarkets and food service providers order on a daily basis and require delivery within no more than 24 hours of placing the order. Tegel submitted that chicken products can be shipped from the North Island to a central South Island location within 24 hours.
150. However, in an internal post-fire document, Tegel stated that if South Island-based customers were to be supplied from the North Island:
- [ ].
151. Figure 1 illustrates the amount of time a supplier would need in order to transport chicken products directly from Auckland to a Christchurch customer.

**Figure 1: Transport Times Auckland to Christchurch**

Notes:

{1} DC: Distribution Centre

152. Figure 2 illustrates the amount of time required to transport chicken products directly from Auckland to a Dunedin customer.

**Figure 2: Transport Times Auckland to Dunedin**

Notes: {1} DC: Distribution Centre

153. Inghams informed the Commission that Foodstuffs SI [

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154. Michael Rozen of Inghams advised the Commission that:

Delivering into Invercargill, the West Coast, Nelson, Dunedin etc – to get a chicken from Te Aroha on a truck after it's been processed fresh, down through to Christchurch and out into the South Island network the day after is almost impossible.

155. The Commission acknowledges that Inghams currently delivers to KFC restaurants throughout the South Island on daily basis and within 24 hours. However, this is made possible by deep chilling the fresh products and by keeping a buffer stock at a central

distribution centre in Christchurch which it leases from its long-haul transporter, Halls. The Commission notes that Inghams can do this because KFC only requires a minimum shelf life of [ ].

### Shelf Life

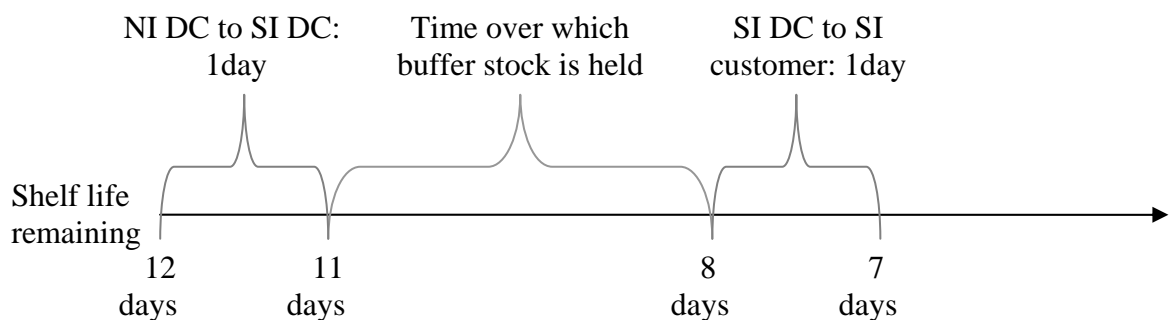
156. The Applicant submitted that the shelf life of fresh, primary and secondary processed chicken products is between eight and ten days. Further, Tegel said that the industry standard in terms of minimum shelf life required by supermarket and food service customers is five days. Tegel further submitted that customers' minimum shelf life requirements can be met if a North Island processor transports fresh chicken products into a South Island distribution centre, storing it there as buffer stock for two days before despatching it to the final customer.
157. The Commission notes that some customers require a minimum shelf life of more than five days beyond delivery. Progressive requires a minimum of [ ] shelf life remaining after delivery at all of its stores throughout New Zealand, Foodstuffs Auckland requires [ ], Foodstuffs Wellington requires [ ] and Foodstuffs South Island requires [ ]. Industry participants advised the Commission that food service customers require at least [ ] shelf life and prefer longer.
158. The shelf life of fresh chicken products from the time of processing depends on a number of factors. First, the quality of processing equipment affects shelf life. For example, the speed at which, and the temperature to which products are cooled down after slaughtering affects shelf life. Secondly, different cuts of meat have different shelf lives due to the varying levels of handling they have undergone and the degree to which they have been exposed to air. For example, a boned out breast is cut into a piece on the day of processing, chilled overnight to assist in the ease of boning, and then deboned the following day. Consequently, secondary processed chicken products have a diminished shelf life.
159. The Commission understands that the shelf life of chicken products that remains after processing in North Island depends on four factors:
- the initial shelf life of the products after processing;
  - the time it takes to transport products from the North Island processing plant to the South Island distribution centre;
  - the time that the products spend at that distribution centre; and
  - the time it takes to transport products from the distribution centre to customers.
160. Inghams advised the Commission that, when leaving the processing plant, the shelf life of its fresh chicken products is [ ]. It stated that the shelf life of its whole birds is [ ] and that its secondary processed products have a shelf life ranging from [ ]. The Commission notes that secondary processed products usually have a shorter shelf life than primary processed products. This is because of the time required for secondary processing and the additional handling involved. For these reasons, the Commission considers that a [ ] shelf life for both primary and secondary processed products is unlikely and adopts in its analysis a shelf life of [ ] for primary processed, and [ ] for secondary processed chicken products.



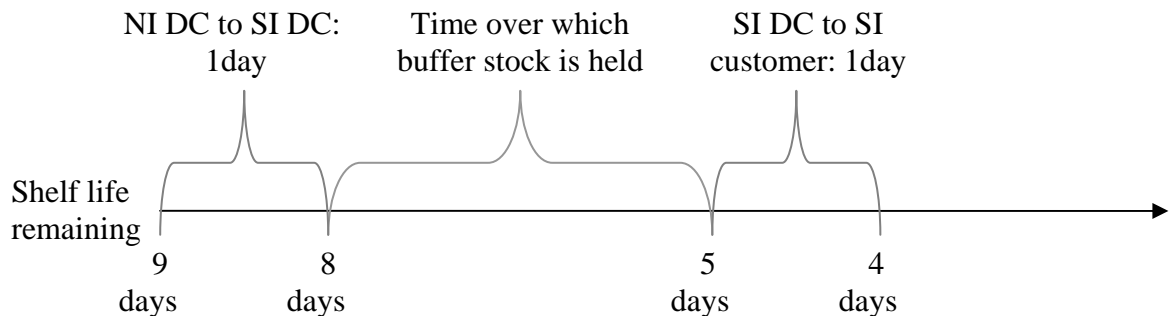
161. As discussed above, the Commission considers that it is possible to transport fresh chicken products from the North Island to a South Island distribution centre within 24 hours.
162. Supermarkets can receive some products at their central distribution facilities. Both Foodstuffs SI and Progressive operate such facilities in Christchurch. Delivering into a central distribution facility assists chicken product suppliers to better meet supermarkets' requirements in terms of speed of delivery. However, security of supply issues would still remain. The Commission has considered whether a North Island processor could overcome these issues by operating its own distribution centre in the South Island. Again, security of supply issues would continue.
163. In order to guarantee speed of delivery and security of supply to South Island-based KFC restaurants, Inghams operates a central distribution facility in Christchurch. From this facility, it distributes fresh chicken products to KFC restaurants from Nelson to Invercargill within 24 hours.
164. Inghams initially advised the Commission [ ] Inghams informed the Commission [ ] Inghams estimated the cost would be several million dollars. Internal board papers from Tegel indicated the replacement value of its distribution facility was \$[ ] million. [ ]
165. Later in the Commission's investigation, Inghams advised the Commission that [ ]
166. As discussed previously, Tegel and Brinks both ship chicken products from the North Island to the South Island which, typically, they deliver to their processing plants in Christchurch for secondary processing and/or distribution to customers throughout the South Island. In essence, their processing plants double as distribution centres, with flows of additional fresh products available continuously from the adjacent processing plant.
167. At its South Island distribution centre, Inghams holds [ ] days of stock in order to guarantee security of supply to KFC. The buffer stock is required for two reasons. Firstly, some buffer stock is required in order to satisfy orders in case replenishment stock to the distribution centre is delayed. Secondly, further buffer is required to accommodate the mix of actual orders that might exceed forecasted orders.
168. Tegel advised the Commission that for a North Island based supplier, a buffer stock of two days would be sufficient to supply supermarket and food service customers in the South Island. However, Inghams advised the Commission that KFC's demand in terms of product mix is relatively constant. On the other hand Inghams advised that the demand of supermarkets is more variable and that trade with individual Foodstuffs stores adds to the variability. Accordingly, the Commission is of the view that a buffer stock of at least three days would be required to reliably supply these customers.

169. It is implicit that such a buffer stock is, on average, three days older when it leaves the distribution centre compared to when it arrives. This is because products pass through the distribution centre on a first-in-first-out basis.
170. The Commission has attempted to illustrate the shelf life remaining after processing and how this impacts on the distribution of fresh chicken products from a North Island processing plant to a South Island customer. For the purposes of this exercise the Commission has adopted Inghams' shelf life figures,[ ]

**Figure 3: Timeline Illustrating Shelf Life of a Whole Fresh Dressed Chicken**



**Figure 4: Timeline Illustrating Shelf Life of Fresh Chicken Pieces**

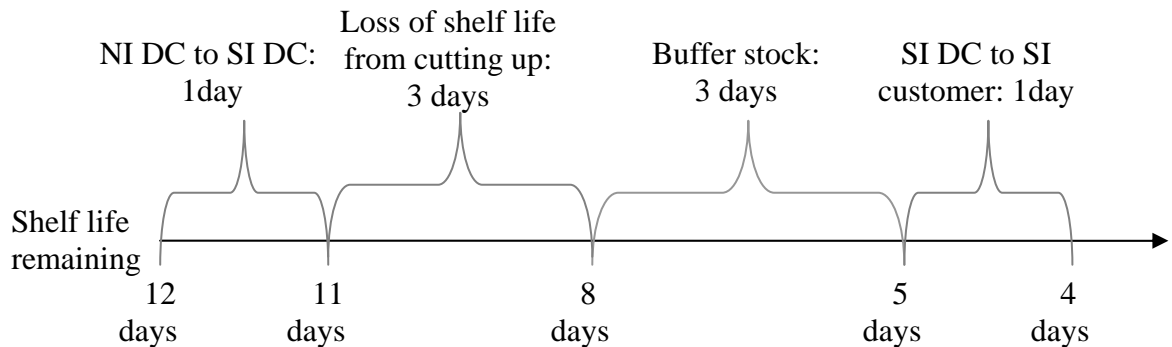


171. These figures illustrate that whole birds shipped from the North Island to a South Island distribution centre would satisfy supermarket and food service customers' minimum shelf life requirements of at least five days. However, this does not apply to secondary processed pieces.
172. Tegel advised that given the longer shelf life of a whole bird delivered to the South Island, a supplier could establish a cutting up facility in the South Island in order to satisfy customers shelf life requirements in respect of secondary processed pieces.
173. The Applicant claimed that a North Island processor could readily enter or expand into the South Island by establishing a cutting up facility there. It stated that very little capital investment would be required. It estimated that a facility to cut up 10,000 birds per week could be set up for approximately [ ].<sup>13</sup>

<sup>13</sup> Tegel's submission dated 14 August 2008, p.7.

174. The Commission accepts that a cutting up facility could be set up relatively cheaply. However, it notes that in shifting the cutting up process from the North Island to the South Island, the deterioration of shelf life that occurs when a whole chicken is cut into pieces and/or deboned is merely delayed. In addition, in the North Island, the majority of cutting up occurs immediately after primary processing. Performing this step in the South Island would require additional time. Figure 5 illustrates this process.

**Figure 5: Timeline Illustrating Shelf Life of a Whole Fresh Dressed Chicken**



175. The Commission has considered whether cutting up in the South Island would enable the supplier to reduce the period over which buffer stock is held. However, given the unreliability of supply of whole birds to the South Island, the supplier would have to hold a buffer stock of whole birds to cut. Further, the shelf life lost through cutting up comes largely from the additional handling as opposed to the processing time required. Accordingly, the buffer stock period would be approximately the same in either case.
176. The Commission is of the view that even if a North Island based supplier were to establish a cutting up facility in the South Island, this would not overcome the shelf life issue in respect of secondary processed chicken products.

#### Quantitative Analysis

177. The Commission analysed price movements over time for chicken products sold in the North Island and South Island. The analysis looked at the correspondence of price movements of average retail prices for fresh and frozen primary and secondary processed chicken sold in the North Island and the South Island. The results of the analysis suggests that prices in both regions follow a similar pattern over time, and that the two islands might be in the same market. However, this conclusion could be misleading, since the products in both islands have common input costs, such as the input cost for chicken feed. For example, if the price of the common input were to rise, this would lead to rises in the prices of chicken products in the two islands, even if they constituted separate markets.
178. Carrying out a more sophisticated type of analysis, the Commission examined movements in relative prices. Stationarity analysis examines the relative price ratio between two geographic areas. The Commission would expect that if prices of two areas are in the same geographic market, the relative price ratio should revert to a constant long-run value (in other words it should be stationary).
179. The results of the stationarity analysis suggests that the price ratio of retail prices of chicken products in the South Island relative to the North Island has no tendency to return to a stable value over the period. The econometric test of stationarity confirmed

the relative price is non-stationary. This indicates that it would be possible to impose a SSNIP without triggering arbitrage opportunities across the North Island and South Island.

180. A further, even more sophisticated technique is one that evaluates the mechanisms by which price changes are transmitted across geographic areas. The analysis is referred to as cointegration analysis. The Commission would expect that if prices of two areas are in the same geographic market, the linear combination of two non-stationary data series to be stationary and, therefore, cointegrated. The results of the Commission's econometric analysis suggest that there is no cointegration between the linear combination of prices in the North and South Islands.
181. In summary, the quantitative analysis carried out by the Commission to assess the geographic scope of the affected markets is consistent with the results of its qualitative analysis, that is that the North Island and South Island form discrete geographic markets.

*Conclusion on Geographic Markets for Supermarket and Food Service Customers*

182. The Commission considers that the competition effects of the proposed acquisition are best assessed under separate North Island and South Island markets, for the following reasons:
- presently, by far the majority of chicken products supplied in the South Island is also processed in the South Island;
  - speed of delivery and security of supply may be adversely affected by weather conditions in the Cook Strait on a limited number of days;
  - supplying customers outside of Christchurch directly from the North Island cannot be achieved inside the timeframe required by these customers without a stock holding depot (or distribution centre) in the South Island;
  - because of shelf life limitations a distribution centre would only assist with the regular supply of whole birds;
  - irrespective of whether a chicken is cut up in either the North Island or South Island, the shelf life will remain the same – a cutting up facility in the South Island would not address the shelf life issue; and
  - the results of a number of quantitative analyses are consistent with the North Island and South Island being discrete geographic markets.

*Quick Service Restaurants*

183. Currently, the major QSR chains, such as KFC, McDonalds and Burger King require processors to provide chicken products for supply on a nationwide basis.
184. As discussed above, Inghams is able to supply KFC with its requirements on a nationwide basis because of the following:
- Inghams deep chills the chicken products;
  - it operates a distribution centre in the South Island; and
  - KFC only requires three days shelf life.
185. For these reasons, the Commission considers that in respect of QSRs, the geographic scope of the market is likely to be national.

### Conclusion on Market Definition

186. The Commission concludes that the markets that would be affected by the proposed acquisition are:

- Upstream markets:
  - i. the national market for the supply of chicken breeding stock;
  - ii. regional markets for the supply of DOCs;
  - iii. regional markets for the provision of chicken growing services; and
  - iv. regional markets for the manufacture and supply of chicken feed.
- Downstream markets for the wholesale supply of primary and secondary processed chicken products to:
  - i. North Island supermarkets;
  - ii. South Island supermarkets;
  - iii. North Island food service providers;
  - iv. South Island food service providers; and
  - v. QSR customers throughout New Zealand

### FACTUAL / COUNTERFACTUAL ANALYSIS

187. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment considering the likely outcome with the acquisition (the factual), and without the acquisition (the counterfactual).<sup>14</sup> Because likely does not mean more likely than not, there may be more than one likely counterfactual.<sup>15</sup> The difference in competition between the factual and counterfactual scenarios is then able to be attributed to the impact of the acquisition.

#### Factual

188. In the factual, Tegel would purchase certain assets and undertaking of the poultry business of Brinks. Excluded from the proposed acquisition are the land and buildings at all of its plants. In addition, Tegel is acquiring only minimal plant from Brinks.

189. [ ]

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- [ ]
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- [ ]
- [ ]

<sup>14</sup> *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No 6)*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

<sup>15</sup> *Woolworths Limited v Foodstuffs (Auckland) Limited; Foodstuffs (South Island) Limited; Foodstuffs (Wellington) co-operative Society Limited ("Foodstuffs") and Ors* HC WN CIV 2007-485-1255{29 November 2007}, 116 b

190. As a result of the acquisition, Brinks would be removed completely as a competitor in the affected downstream poultry markets. Brinks would also be removed as an acquirer of key inputs in the upstream markets. Further, Brinks' grower contracts would be assigned to Tegel and there would be a restraint of trade, thereby preventing Brinks from re-entering the markets for [ ] years.

### Counterfactual

191. The counterfactual is the Commission's view of what would be likely to occur if the acquisition being considered were not to proceed. It is the benchmark against which any changes arising from the proposed acquisition is assessed. When making this assessment, the Commission recognises that future scenarios may include either the existing owners continuing to control the target entity, or other parties that are interested in purchasing the target entity if the Applicant's proposed acquisition were not to proceed and the sale to continue.
192. Where there is more than one real and substantial counterfactual, it is not a case of choosing the one that the Commission considers has greater prospects of occurring.<sup>16</sup> Rather the Commission is to consider each of the possible counterfactuals that are real and substantial possibilities. Each of these real and substantial possibilities becomes a counterfactual against which the factual is to be assessed. The Commission is to then discard those possibilities that have only remote prospects of occurring. This assessment is an evidence based exercise.
193. If each of the counterfactuals is likely (i.e. each of the counterfactuals is not a remote possibility), all likely scenarios must undergo a competition analysis to assess whether a substantial lessening of competition would be likely to arise.

### *The Applicant [ ]'s View of the Counterfactual*

194. Tegel considers that in the counterfactual, Brinks would need to consider rationalising its existing three sites on to one new facility to achieve a cost effective growth option. Tegel estimates this would involve a \$[ ] capital cost. Alternatively, Tegel submitted that Brinks could continue to operate its "limited competitor" model with its present constrained capacity.

195. [

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<sup>16</sup> *Woolworths Limited v Foodstuffs (Auckland) Limited; Foodstuffs (South Island) Limited; Foodstuffs (Wellington) Co-Operative Society Limited ("Foodstuffs") and Ors* HC WN CIV 2007-485-1255 {29 November 2007}, 118.

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*Sale of the Brinks' Poultry Businesses to Another Party*

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*Conclusion on the Counterfactual*

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225. In summary, the Commission concludes that there is more than a remote possibility of a counterfactual occurring that is equivalent to the status quo. This is the case for Brinks' operations in both the North Island and South Island.

### **COMPETITION ANALYSIS – UPSTREAM MARKETS**

226. In respect of the upstream markets, the Commission considers whether the proposed acquisition would be likely to result in a substantial lessening of competition as a result of:

- the horizontal aggregation in the chicken growing services markets; and
- the potential vertical effects in the chicken breeding stock market, supply of DOCs, chicken growing services and chicken feed market.

227. The Applicant submitted that the availability of key industry inputs (animal feed, contract growers, and broiler DOCs) will be unaffected by the transaction. In addition, the transaction will not lead to any new vertical integration. The Applicant therefore submitted that no competition concerns arise at those upstream levels.

228. The Commission is of the view that horizontal aggregation will occur in the market for growing services.

229. The Commission is of the view that, in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless market power exists at one of the affected functional levels. In this instance, the Commission will consider whether the acquisition would enhance market power in any of the upstream or downstream markets.

### **Chicken Breeding Stock / DOCs**

230. Currently, Aviagen exclusively supplies the Ross Bird to Tegel, and Bromley Park supplies the Cobb Bird to Inghams and Spring Chicken. [ ] This suggests that, in the factual and counterfactual, access to the Ross breeding stock would be available from Aviagen to any downstream customer purchasing chicken breeding stock. If Bromley Park were to exit the market, Aviagen would likely be the sole supplier of breeding stock to external parties. This would be the case in both the factual and counterfactual scenarios.

231. In the factual, [ ]. Bromley Park submitted that the proposed acquisition would result in it exiting both the chicken breeding stock and the DOC markets. This is because Brinks represents [ ]% of Bromley Park's business. However, [

]

232. Bromley Park expressed the concern that the proposed acquisition might result in:  
 increased vertical integration making it more difficult for existing non-vertically integrated firms to compete, and for new firms to enter, in absence of any independent source of the key input of DOCs.
233. The Commission considers that competition in the markets for breeder stock and DOCs could be adversely affected by the exit of Bromley Park. However, [ ] Therefore, the Commission concludes that the acquisition will not have, or would not be likely to have, the effect of a substantial lessening of competition in the markets for the supply of breeding stock and DOCs.

### **Chicken Growing Services**

234. As the competition issues arising from the proposed acquisition are likely to be similar in each of the affected regional markets, the Commission considered them jointly.
235. In the factual, Tegel would take assignment of [ ] grower contracts from Brinks. Of those growers [ ] The Applicant is of the view that the transfer of these growers would not lead to any significant change in the provision of contract grower services.
236. Processors already dictate the terms on which contract growers provide services, for example the number and weight of chickens grown and the provision of feed. The Commission notes that there is a degree of interdependency between processors and contract growers because once the processor has decided on its level of output, it needs to maintain sufficient growers to satisfy the required level of inputs.
237. The Commission is of the view that the proposed acquisition is unlikely to materially change the relationship between processors and growers. This is because of the minimal degree of aggregation and the fact that processors already dictate the terms on which growers provide services. Therefore, the Commission concludes that the proposed acquisition will not have, or would not be likely to have the effect of substantial lessening competition in the chicken growing services markets.

### **Chicken feed**

238. In terms of the supply of feed, the Commission considered whether the merged entity would influence the access to broiler feed, a key input into chicken production.
239. With regard to feed supply in the North Island regions, Tegel, Inghams, Turks and Spring Chicken all self-supply. Presently, Brinks takes its feed supply from Inghams, this is due in part to the fact that Inghams and Brinks grow the same breed of chicken. In the factual scenario, Brinks' capacity will be assumed by Tegel who grows a different breed of chicken. [ ]. Therefore, the Commission considers that in the North Island there will be no difference between the factual and counterfactual scenarios.
240. With regard to feed supply in the South Island regions, a similar situation exists. In both the factual and the counterfactual, [ ].

241. The Commission further considers that entry into chicken feed production by other animal feed producers appears relatively easy and that Spring Chicken included a feed production facility in its entry.
242. Therefore, the Commission considers that the proposed acquisition would be unlikely to result in any material change in the market situation compared to the counterfactual. Therefore, the Commission concludes that the proposed acquisition will not have, or would not be likely to have the effect of substantial lessening competition in the markets for the supply of chicken feed.

### **Overall conclusion on upstream markets**

243. The Commission considers that the proposed acquisition would not result in any material difference between the factual and counterfactual scenarios, in the markets for:
- the supply of chicken breeding stock;
  - the supply of DOCs;
  - the provision of chicken growing services; and
  - the supply of chicken feed.
244. Therefore, the Commission concludes that the proposed acquisition will not have, or would not be likely to have the effect of substantial lessening competition in any of these markets.

## **COMPETITION ANALYSIS – THE NORTH ISLAND SUPERMARKET MARKET**

### **Existing Competition**

245. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).
246. Foodstuffs Auckland and Foodstuffs Wellington both buy chicken products from Tegel, Brinks, Inghams and Turks. The Commission understands that Spring Chicken currently supplies a small number of PAK'nSAVE supermarkets in the Auckland area.
247. An examination of concentration in a market can provide a useful indicator of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.
248. Table 3 sets out the estimated market shares of processors that supply primary and secondary processed chicken to North Island supermarkets. These figures are based on the value of wholesale sales of primary and secondary processed fresh and frozen chicken products in 2007.<sup>17</sup>

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<sup>17</sup> For the purpose of this investigation, the Commission considers that it is more informative to measure sales in terms of value, rather than number of birds. This is because some processors sell disproportionately large amounts of selected cuts to some customers. For example, Inghams sells a disproportionate amount of breast fillets to quick service restaurants and consequently a disproportionate amount of cuts other than breast fillets to supermarkets and food service providers. Different cuts sell at different wholesale (and retail) prices. Measuring market shares in terms of value, as opposed to number of birds, is more informative as it takes into account difference in sales patterns and differences in wholesale prices.

**Table 3: Estimated Market Shares for the Supply of Primary and Secondary Processed Chicken Products to North Island Supermarkets in 2007**

Participant	Value (NZ\$m)	Share (%)
Tegel	[ ]	[ ]
Brinks	[ ]	[ ]
<i>Combined entity</i>	[ ]	[ ]
Inghams	[ ]	[ ]
Turks	[ ]	[ ]
Spring Chicken	0	0
Total	[ ]	100

Source: Tegel, Brinks, Inghams, Turks and Spring Chicken

249. The table above shows that in 2007, Tegel accounted for [ ] % of sales to supermarkets in the North Island. This would increase to [ ] % in the factual. The three-firm concentration ratio would increase from [ ] % to [ ] % post-acquisition. This is outside the Commission's safe harbours.
250. Table 3 above shows that Spring Chicken has a market share of 0%. This is because the table uses 2007 data; Spring Chicken commenced production in 2008.
251. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

#### Tegel

252. In 2007, Tegel supplied each of Foodstuffs and Progressive in the North Island with \$[ ] million worth of primary and secondary processed chicken products. Tegel supplies around [ ]% of Progressive's chicken product requirements. In 2007, Tegel supplied around [ ]% of Foodstuffs' chicken product requirements. Accordingly, Tegel is the largest participant in this market.

253. Tegel submitted that [

].

254. However, Andrew Stevens, Chief Operating Officer, Tegel also advised the Commission that it and Inghams follow the same strategy; “[

]”.

#### Inghams

255. In 2007, Inghams supplied Foodstuffs and Progressive in the North Island with \$[ ] million and \$[ ] million, respectively, worth of primary and secondary chicken meat products. Inghams supplies around [ ]% of Progressive's chicken product requirements. In 2007, Inghams supplied around [ ]% of Foodstuffs' chicken product requirements. Accordingly, Inghams is the second largest participant in this market.

256. Tegel said that Inghams' New Zealand operations were more efficient than Tegel's and that this makes Inghams a “highly competitive force in the New Zealand market”. [

] Michael Rozen of Inghams stated that,

[

]

257. In addition, Inghams advised the Commission that [

] Mr Rozen told the Commission that:

[

]

### Brinks

258. In 2007, Brinks supplied Foodstuffs and Progressive in the North Island with \$[ ] million and \$[ ] million, respectively, worth of primary and secondary chicken meat products. Brinks supplies around [ ]% of Progressive's chicken product requirements. In 2007, Brinks supplied around [ ]% of Foodstuffs' chicken product requirements.

259. Tegel advised that Brinks does not have any material impact on Tegel's pricing and that Brinks competes mainly for food service customers and to a far lesser degree for supermarkets. Tegel further submitted that Brinks does not have a history of aggressive, independent pricing behaviour (rather than following the lead of other businesses). Brinks tends to follow the lead of market pricing usually set either by Tegel or Inghams. On some products, an inferior product/quality/service offering means it may have to sell at a discount, but in terms of market trends or particular promotional behaviour, Tegel's view was that Brinks rarely leads the market.

260. However, almost all industry participants interviewed by the Commission consider that Brinks is a low cost and vigorous competitor. For example, Michael Rozen of Inghams told the Commission that:

My view on Brinks is that they would be a price leader in the marketplace. [ ]... From a pricing point of view, Brinks is a vigorous competitor [ ].

[

]

261. In addition, Ron Turk, director of Turks stated that:

[

]

262. Progressive also views Brinks as a supplier that induces other suppliers to lower their prices; that it is a catalyst for lower prices. Brett Ashley, General Manager, Fresh Foods, Progressive, advised the Commission that:

[ ]

In Mr Ashley's opinion, the reason Brinks is able to offer the best prices is that it has lower overheads than Tegel and Inghams.

263. Mark Baker, General Manager Retail of Foodstuffs Auckland, submitted that:

We look at suppliers' prices and pick the best deal we can get. Inghams is very competitive on back end {wings, drums, thighs} ... Brinks being very competitive on front end {breast fillets}.

264. With regard to the effect of the proposed acquisition, Mr Baker stated that:

they {Brinks} are able to keep the market honest... If they left the market that same level of tension would not be there.

265. The Commission has attempted to assess the degree to which cost structures differ across processors. To this extent, it requested data detailing the cost of producing primary and secondary processed chicken products. However, the data supplied in response to the Commission's requests was subject to numerous assumptions that differed across suppliers which made a comparison of costs across processors uninformative.
266. However, the Commission considers that small processors, such as Brinks, may have lower production costs than larger processors, such as Tegel and Inghams. This is because of factors such as the leaner corporate structure required to operate a smaller company. The Commission recognises; however, that once a certain size has been reached, economies of scale may be realised.
267. Tegel argued that if Brinks offered prices below those offered by its competitors, it would be reasonable to expect that Brinks' market share would have increased. In Tegel's view, this has not happened. However, the Commission is of the view that Brinks' lower prices would not necessarily increase its sales. For example, if Tegel revised its initial price to supermarkets in response to a lower price offered by Brinks, Brinks would not necessarily gain additional sales but it would have had the effect of exerting downward pressure on prices. In essence, although Brinks might not gain market share as a result of its strategy, it might prevent the company losing market share.

#### Turks

268. Turks supplied \$[ ] million worth of primary and secondary chicken meat products to Foodstuffs Auckland and to Foodstuffs Wellington. Turks is not an approved supplier for Progressive. Turks supplies less than [ ]% of Foodstuffs' chicken product requirements.
269. Tegel considers that Turks provides a degree of competitive constraint with regard to servicing supermarket customers. In Tegel's view, Turks has traditionally had a strong relationship with Foodstuffs Wellington and its presence is now also being felt in Foodstuffs' supermarkets in Auckland.
270. Turks submitted that, [ ]. When asked how it communicated price increases with its customers, Ron Turk of Turks stated that:
- [ ]
271. The Commission asked Foodstuffs Auckland what options the company would have if the merged entity were to increase prices by 5% to 10%. Mark Baker stated that it could only switch to Inghams, as Turks would not be a viable alternative.
- [ ]
272. The Commission notes that Turks chicken products are differentiated to some degree from those produced by Tegel, Brinks, and Inghams. This is because Turks mainly processes corn-fed, free-range chickens, whereas Tegel, Brinks and Inghams mainly process conventional chickens. Tegel sells some corn-fed, free-range chickens under its Rangitikei Corn Fed Free Range brand.



### Spring Chicken

273. Given Spring Chicken's recent entry and the company's unsteady start, the Commission considers that there may be uncertainties regarding the future success of the company.

274. Spring Chicken advised the Commission that [

].

### **Expansion of Existing Competitors**

275. The degree of competitive constraint imposed on a merged entity by existing or near competitors, especially if they are small, depends upon their ability to expand in response to the incentive provided by the exertion of market power.

276. A chicken processor's ability to increase output depends on two variables: first, the processor's ability to increase the number of chickens grown, and secondly, the processor's ability to process the chickens.

277. The Commission gathered data showing (a) the current levels of production of Tegel, Inghams and Turks, and (b) the extent to which this level of production could be increased without physically extending the scope of the operations or altering resource consents.

278. Table 4 shows the estimated levels of capacity utilisation with regard to growing and processing chickens, using 2007 data for Tegel, Inghams, and Turks. It should be noted that the figures in Table 4 relate to the North Island production and not just the North Island supermarket market because of the ability of suppliers to switch between supermarket and food service customers.

279. The maximum capacity is based on two daily shifts and assumes no physical extension to any operations or alterations of any resource consents. However, in order to further utilise current levels of capacity, additional staff are likely to be required.

**Table 4: Estimated Levels of Capacity Utilisation with Regard to Growing and Processes Chickens in the North Island in 2007**

<b>Participant</b>	<b>Number of chickens grown (millions of birds per annum)</b>	<b>Capacity utilisation - growing</b>	<b>Number of chickens processed (millions of birds per annum)</b>	<b>Capacity utilisation – processing</b>
Tegel	[ ]	[ ]%	[ ]	[ ]%
Brinks	[ ]	[ ]%	[ ]	[ ]%
Inghams	[ ]	[ ]%	[ ]	[ ]%
Turks	[ ]	[ ]%	[ ]	[ ]%

280. Post acquisition, Tegel would incorporate Brinks' North Island capacity into its existing North Island processing facilities. Assuming that Tegel did not also incorporate any of Brinks' South Island production in its North Island facilities, the combined entity would utilise [ ]% of its available processing capacity. Therefore, Tegel would have significant spare capacity in both the factual and counterfactual.

281. Brinks [ ] capacity is constrained by resource consents that limit the exposure of Brinks' neighbours to noise and odour pollution. This is unlikely to change in the future.
282. Inghams [ ]. Industry participants advised the Commission that the cost of an additional shed is between \$500,000 and \$1 million. The Commission notes that in the past, Inghams invested \$120 million including expanding its operations in order to meet the requirements of the KFC contract. To this extent, the Commission considers that the investment required for extra sheds would not be a significant expansion hurdle for Inghams. The Commission therefore considers that Inghams could expand its production within the requisite timeframe if it decided to do so.
283. With regard to increased levels of output, Michael Rozen of Inghams referred to the oversupply situation after the KFC contract went from Tegel to Inghams in 2003:  
[ ]
284. [ ] the Commission considers that there is uncertainty as to whether Inghams would compete on price or whether it would simply continue to follow Tegel.
285. Table 4 indicates that Turks currently operates at approximately [ ]% of its available capacity[ ] planning to expand its production [ ]  
]. This output compares with Brinks' current production of around [ ] million birds per year. [ ]
286. Turks advised the Commission that [ ] The Commission notes that [ ] The Commission further notes that Turks' products are differentiated from those of other North Island processors' due to their chickens being corn-fed and free-range. For these reasons, the Commission has doubts whether Turks would expand its production as a competitive response to an exercise of market power by the combined entity.
287. Spring Chicken advised the Commission that it plans to [ ]
288. As outlined previously, Spring Chicken experienced initial financial and operational difficulties. In view of Spring Chicken's recent history, the Commission considers there are uncertainties regarding the future success of the company. In addition, the Commission has doubts about whether Spring Chicken would expand its production in response to the combined entity increasing prices.
289. In summary, in the factual scenario, Inghams, and Turks could expand their output in response to a price increase. However, the Commission has doubts as to whether either party would do so because of [ ]

]

### **Conclusions on Existing Competition**

290. The proposed acquisition would reduce the number of large chicken processors in the North Island from three to two, with two smaller fringe players (Turks and Spring Chicken) still remaining. In addition, there are two smaller processors (Turks and Spring Chicken) in both the factual and counterfactual.
291. The Commission considers that, in the counterfactual, the players' behaviour in this market is likely to be similar to the current situation. In particular, Brinks would continue to:
- be the catalyst for lower prices;
  - have a cost structure different from Tegel and Inghams making its behaviour less predictable; and
  - provide competitive tension in the market.
292. In the factual, Brinks would be removed from the market and its competitive behaviour and the consequences thereof would cease to exist.
293. In the factual, the combined entity's main competitor would be Inghams. While there is some evidence that Tegel and Inghams compete, there is also evidence that [ ]. Turks and Spring Chicken process significantly fewer chickens. [ ]. Even though Turks and Spring Chicken are likely to have some spare capacity in their processing plants, it is unlikely to be sufficient for them to counteract the effects of a 5% to 10% price increase by the combined entity. In addition, the Commission is unsure of Spring Chicken's size in the future.

### **Potential Competition**

294. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try.

#### *Conditions of Entry*

295. It should be noted that the analysis of entry conditions is generic to the North Island and does not exclusively apply to the North Island supermarket market. This is because of the ability of suppliers to switch between supermarket and food service customers.
296. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of market conditions that impede entry.
297. A potential mode of entry into some markets is through importation. However, in New Zealand, the importation of fresh and frozen chicken products is prohibited under the Biosecurity Act 1993 unless it has been cooked to specific time and temperature levels. Accordingly, there is no likelihood of entry to this market by means of importation within the requisite timeframe.

298. Tegel submitted that new entry on a fully vertically-integrated basis and on an equivalent scale to Tegel and Inghams would require an investment of many millions of dollars. It does not consider entry on such a scale is likely within the Commission's general two year time frame. The Commission agrees with this assessment.
299. However, Tegel submitted that "entry to the market on a small to medium (but sustainable) basis is relatively straightforward." Further, the Applicant contended that the entry of Spring Chicken, which is on a fully vertically-integrated scale, demonstrates that it is feasible to do so within two years.
300. The Commission has identified the following entry conditions that are relevant to the competition analysis of this market:
- capital, plant, and equipment;
  - regulatory requirements including resource consents;
  - access to inputs into poultry production (i.e. breeding stock, DOCs, feed); and
  - scale of operation.

#### Capital, Plant and Equipment

301. The production of chicken products requires specialised plant and equipment that cannot be used to produce any product other than chicken. Tegel submitted that processing equipment can be sourced either new or second hand.
302. Spring Chicken has entered the market by leasing facilities and purchasing second hand processing equipment. However, Will Wilson, former Chief Executive of Spring Chicken, commented that shortly after the plant was commissioned, problems developed with two items of equipment (the plucker and spiral chiller). In hindsight, Mr Wilson considered that new plant would have provided more reliable technology, and would not have been significantly more expensive.
303. Entry into chicken processing may involve upstream integration into one or more of the input markets. If so, entry into each additional input market would increase costs, increase the time required for entry, and add to the risk of entry.
304. Spring Chicken informed the Commission that by the time it reaches optimum capacity, the total capital cost of its entry will be in excess [ ]. The Commission estimates that around the time it commenced processing, Spring Chicken had spent about [ ] on its operations, comprising:
- [ ] million on a feed mill;
  - [ ] million on a quarantine farm;
  - [ ] million on a hatchery;
  - [ ] million on (upgrading) a breeding farm;
  - [ ] million on breeding stock; and
  - [ ] million on the processing plant.

Since commencing processing, Spring Chicken has incurred further expenditure of more than \$[ ] million.

305. However, Tegel submitted that entry could be achieved at a lower cost by entering on a partially vertically-integrated basis. The Commission agrees that entry on such a basis

would lower costs, although there might be disadvantages associated with this such as having no control over the supply of some inputs.

306. Spring Chicken advised the Commission that if it had not entered on a fully vertically integrated basis the entry cost would likely to have been around \$[ ] million. However, Spring Chicken also advised that, initially, it did not plan to enter on a fully vertically integrated basis. Rather, it anticipated to obtain DOCs from Bromley Park and feed from PCL. However, Spring Chicken failed to reach supply agreements with either party.

#### Regulatory Requirements Including Resource Consents

307. The chicken industry is subject to a range of regulatory controls, including biosecurity, animal welfare, and resource management legislative requirements.
308. Under the Animal Products Act 1999, all primary chicken processors are required to have approved risk management programmes (RMPs) in place. These cover a range of processes, including how the processor manages food safety, pest control and product testing. Birds must also be tested for generic Salmonella, E. coli and Campylobacter, with the results having to be reported to the NZFSA.
309. The Commission considers that incumbents incur ongoing costs to ensure compliance with the relevant legislation is achieved, but that new entrants would be faced with the costs of preparing the necessary documentation (e.g. RMPs).
310. A new entrant would also be required to obtain resource consents, which are administered by territorial local authorities in terms of the Resource Management Act 1991 (RMA).
311. Tegel submitted that such requirements are not materially different for many sectors of the economy seeking to invest in new manufacturing, and if situated in the right zone or area, is not necessarily difficult for a chicken processor to obtain consents. Further, it states that existing processors also face ongoing compliance costs with the RMA.
312. Brent Greig, current Chief Executive of Spring Chicken, stated that it took a relatively short period of time to obtain consents for its operations, with the resource consent process for its quarantine farm, hatchery and processing facilities being completed within 12 months. The resource consent for its processing plant was facilitated by the fact that the site had been used previously by Nestle for a food processing plant and had existing consents.
313. [ ]

#### Access to Chicken Processing Inputs

##### Breeding Stock/DOCs

314. The Commission considers that the most likely way of acquiring DOCs is by entry at the parent breeder or DOC levels. A new entrant could acquire parent breeding stock from Aviagen. Aviagen is currently supplying Tegel, but has advised the Commission that it will supply Ross parent breeders to any other interested party. [ ]

An entrant at this level would also require a DOC hatchery.

315. In regard to access to DOCs, presently, there are two sources of supply: Tegel; and Bromley Park. However, if Bromley Park exit the market, Tegel would be the sole source of supply for DOCs. [

] <sup>18</sup> Currently, Tegel is supplying [ ] with DOCs.

However, there may be competition issues, for example foreclosure, if a new entrant into processing is required to rely on a competitor for a key input.

316. As previously discussed, if Bromley Park exits the market, then it is likely that the licensing rights for the Cobb bird would become available to other parties and as such, a new entrant might be able to secure these rights to ensure the availability of DOCs.

#### Growers

317. A new entrant would need to secure enough growers to grow a sufficient supply of broiler chickens. Historically, there have been sufficient growers available to supply broiler chickens for processors. A key investment for growers is sheds.

318. As previously discussed, the cost of a growing shed is between \$700,000 and \$1 million. A new entrant would require several sheds. Without a track record, it may be difficult for a new entrant to persuade growers to invest in buildings and plant and start growing for them. This is because there is more risk involved. In order to mitigate this risk, the processor could negotiate a longer lasting term contract with the grower but would need to demonstrate financial strength to convince the grower to invest in committed capacity for the new processor. The Commission notes that this problem was overcome by the growers setting up their own processing company in the case of Spring Chicken.

#### Broiler Feed

319. The Commission considers that the following factors are relevant when considering access to feed supplies:

- some feed mills supply broiler feed to third parties (e.g. Inghams supplies feed to Brinks);
- there are other smaller suppliers of broiler feed, such as Feedco <sup>19</sup> (currently a supplier to Brinks), and Mainland (PCL Feeds), which is a vertically integrated egg production company;
- there is scope for existing stock feed producers not involved in broiler feed production to expand into making this product; and
- entry into broiler feed production has been demonstrated, including by Turks, Spring Chicken, and FeedCo, all of which entered broiler feed production for self-supply.

320. For these reasons, the Commission considers that access to feed is unlikely to be difficult.

#### Scale

321. Some industry participants claimed that processors require a minimum scale of operation to compete for supermarket sales.

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<sup>18</sup> [ ]

<sup>19</sup> [ ]

322. The Commission notes that processors can sell chicken to individual stores in the Foodstuffs' cooperatives. For instance, Turks has already successfully managed to supply Foodstuffs stores in the North Island. Spring Chicken has also been supplying a small number of PAK'n'SAVE stores in the Auckland area, as well as Warehouse Extra stores.
323. However, to effectively compete for supermarket sales, the Commission considers that it is necessary for a processor to be of sufficient scale. [

] Mr Dave Burnett, the owner of Feedco and the former owner of Canterbury Chicken, advised that the company commenced the processing of chicken in 1985 and grew to [ ] million birds per annum by 2003. However, Mr Burnett considered that the plant was of insufficient scale to compete for supermarket sales. Mr Burnett decided to sell the business in 2003 to Brinks rather than incur the additional capital costs to expand the plant to the next level of production.

324. The Commission is of the view that, in order to satisfy the requirements of a significant number of supermarkets on a regular basis, in terms of both volume and product mix, a processor would require significant scale.

**Example of Entry: Spring Chicken**

325. Spring Chicken was founded by 12 former contract growers for Brinks and Tegel and was incorporated in August 2005. Mr Said Abu Awad, a founding director and shareholder in Spring Chicken, advised the Commission that planning commenced in mid-2006.

326. [

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327. [

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328. Spring Chicken then decided to approach Hubbard, the holder of the global rights to the Hubbard bird, to secure supply of breeding stock. In May 2007, Spring Chicken was awarded the New Zealand licensing rights to the Hubbard bird. Spring Chicken then commenced importing parent breeder stock to expedite the breeding process with the first breeding stock arriving in September 2007. Spring Chicken received further supplies of parent breeding stock in December 2007. It also commenced importing grand parent stock with the first shipment in April 2008.
329. Spring Chicken acquired a quarantine farm, costing \$[ ] million, a hatchery, costing \$[ ] million, breeding farms, costing \$[ ] million, and breeding stock, costing \$[ ] million. The company also purchased second-hand processing equipment, and acquired a site at Waiuku to undertake the primary and secondary processing of chicken meat.
330. After an unsuccessful attempt to obtain feed from PCL Feeds (a division of Mainland Poultry Limited and a producer of stock feed), Spring Chicken entered into a 50/50 joint venture agreement with Takanini Racing and Stock Feeds for the manufacture of its own broiler feed (estimated cost April–July 08 \$[ ] million).

331. Spring Chicken commenced production on 3 June 2008, but experienced immediate commissioning problems. As a result, the company was forced to restrict its processing capability to [ ] million birds per annum. [ ]

332. [

]

333. [

]

334. In addition, Spring Chicken has decided to close its breeding and hatchery operations and instead will source its DOCs from Bromley Park.

335. Spring Chicken is currently processing about [ ] million birds per annum, and is planning to increase its production to [ ] million birds per annum by February/March 2009. So far, the company has concentrated primarily on supplying primary and secondary processed chicken products to food service providers. However, in future it intends to supply [ ].

#### **The “LET” Test**

336. As for the analysis of entry conditions, it should be noted that the LET test is also generic to the North Island and does not exclusively apply to the North Island supermarket market.

337. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:

- Likely in commercial terms;
- sufficient in Extent to cause market participants to react in a significant manner; and
- Timely, i.e. feasible within two years from the point at which market power is first exercised.

#### *Extent of Entry*

338. If it is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. Entry that might occur at only relatively low volumes, or in localised areas, does not represent a sufficient constraint to alleviate concerns about market power.

339. In the past, although entry has been achieved on a small scale, such entrants have only been successful in obtaining a limited market penetration. There have been a number of processors that have commenced small scale processing, but have never successfully managed to increase their scale sufficiently to effectively compete in chicken processing (e.g. Canterbury Chicken, Pacifica).

340. The only possible exception to this pattern of ineffectual, small-scale entry (from a competition perspective) is Inghams, an offspring of a very large Australian chicken processor. Its entry occurred following the acquisition in 1990 of the assets of an



existing player in the North Island (Harvey Farms), in which it has invested around \$120 million in subsequent years.

341. The Commission notes that apart from Turks and Brinks, small entrants have either been acquired or ceased to operate. The Commission further notes that the scale of Turks' operations has not enabled it to provide significant competitive tension with regard to pricing. Even after its intended expansion, Turks considers that it would not be price competitive with Brinks. Also, Turks' products are differentiated from those of other North Island processors' due to being corn-fed and free-range.
342. Therefore, the Commission concludes that if entry is to be sustainable and effective in this market, it would need to occur on a scale similar to that of Brinks.

#### *Timeliness of Entry*

343. To effectively constrain the exercise of market power, entry must also be timely. If it is to alleviate concerns about a substantial lessening of competition, entry must be feasible within a reasonably short timeframe, which the Commission typically considers to be two years, from the point in which market power is exercised.
344. Spring Chicken's entry, which was on a fully vertically integrated basis, has taken it in excess of two years to reach its present capacity of [ ] million birds per annum. In addition, it is likely to take Spring Chicken a further [ ] to reach its full capacity of around [ ] million birds per annum. Further, the Commission notes that Spring Chicken had a number of advantages in terms of its entry, for example, it had existing growers and sheds and the fact that it set up its operations in an existing use facility expedited the gaining of its resource consents.
345. The Commission recognises that entry would not have to be effected on a fully vertically integrated basis. However, the Commission notes that not all steps in setting up a fully vertically-integrated operation need to be carried out sequentially, rather they could occur concurrently. It is therefore not clear to what extent, if at all, entry on a non-fully vertically integrated scale could be achieved more quickly than fully vertically integrated entry.
346. The Commission considers it unlikely that entry would occur with the sole target being the supply of supermarkets. Rather, an entrant is likely to build up size gradually through selling to other markets in the early stages.
347. To this extent, the Commission is of the view that even non-fully vertically integrated entry may still be unlikely to occur inside two years.

#### *Likelihood of Entry*

348. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on investment, including an allowance for any risks involved. The Commission has considered whether entry would be likely if the combined entity were to increase prices by 5% to 10%.
349. With regard to past entry, the Commission notes that there has been small-scale entry into primary and secondary chicken meat processing. While small-scale, while possibly being commercially successful, is unlikely to significantly contribute to the level of competition in a market. Except for Turks and Spring Chicken, such entrants have either failed or been acquired. Further, Spring Chicken [

]. Even after its recapitalisation, the Commission has some doubts about the future success of Spring Chicken.

350. The Commission considers that if entry is to be sustainable and effective with regard to competition, it would need to occur on a scale significantly larger than Turks' and Spring Chicken's anticipated size and it would need to occur within a two year period. For the reasons outlined above, the Commission does not consider this to be likely in the event of a 5% to 10% price increase.

*Conclusion on the "LET" Test*

351. In view of these factors, the Commission considers that *de novo* entry into the North Island supermarket market does not satisfy the LET test.

*Conclusion on Potential Competition*

352. Considering the conditions of entry in the round and applying the LET test, the Commission concludes that in the factual the combined entity would face limited constraint from potential competition.

**Countervailing Power**

353. The potential for a business to wield market power may be constrained by countervailing power in the hands of its customers. Exercising market power would involve customers switching purchases from one supplier to another, or the credible threat that they might do so.
354. The combined entity may be constrained if purchasers were able to exert a substantial influence on the price, quality or terms of supply of the good or service. A purchaser would be able credibly to exert such countervailing power if it were large in relation to suppliers, well informed about alternative sources of supply, and readily able to switch from one supplier to another.
355. The Applicant submitted that large supermarket retailers hold extensive countervailing power across most food categories that they stock. The Applicant noted that some supermarkets order chicken products in a spot-market type manner. To this extent, it argued that supermarkets have the ability to compare prices and to switch suppliers at short notice.
356. Table 5 sets out the proportion of the major players' total sales that are made to supermarket chains in the North Island.

**Table 5: Proportion of Major Chicken Meat Processors' Total Sales to Foodstuffs, Progressive and Other Customers in the North Island (Using 2007 Value Sales of Primary and Secondary Processed Chicken Meat Products)**

Participant	Proportion of value sales (%)		
	Progressive	Foodstuffs	Customers in other markets
Tegel	[ ]	[ ]	[ ]
Brinks	[ ]	[ ]	[ ]
Inghams	[ ]	[ ]	[ ]
Turks	[ ]	[ ]	[ ]

Source: Tegel, Brinks, Inghams, Turks

357. Table 5 shows that supermarket customers represent a large proportion of Tegel, Brinks, and Inghams' sales of chicken meat products. It is the presence of buyer concentration that gives rise to the potential for countervailing power. To this extent, presently a switch by a supermarket of a meaningful proportion from one supplier to others would have a very real effect on the supplier that is losing volume. However, in the factual scenario, the supermarkets would have only Tegel and Inghams as processors with any significant [ ] scale to chose from.
358. The Commission notes that chicken processors require time to meet an increased level of demand by large customers, such as supermarkets. This is because any significant additional volume sales require additional chickens to be grown. The resulting lead time required for processors to do so makes it difficult for supermarkets to shift quickly significant volumes between processors, especially if they wish to do so repeatedly.
359. Given the lead time required for processors to increase chicken production, shifting significant volumes between two major players is likely to be more difficult.
360. The Applicant submitted that promotional specials in supermarkets make up a large volume of weekly sales by attracting consumer spending towards promoted items. Progressive rotates the main chicken meat suppliers' promotions frequently. For this reason, Tegel stated that its share of supermarket sales is volatile, and could change quickly if Tegel's prices were not competitive.
361. However, as stated above, shifting significant volumes between only two players requires forward planning on the part of the processor, which could result in a lag between attempted price increases by one processor and actual increased supply by the other. Foodstuffs Auckland advised the Commission that it "often needs to supplement promotions with other brands as one company generally can't supply all products".
362. Previously, the Commission has considered the countervailing power of supermarkets in respect of the supply of other fast moving consumer goods where a high proportion of sales are in supermarkets.<sup>20</sup> In those instances, the Commission concluded that supermarkets have significant countervailing power.
363. In Decision 562, which related to Fonterra's acquisition of New Zealand Dairy Food's butter assets, the Commission concluded that there were several ways in which supermarkets could exercise their countervailing power in the event that Fonterra should attempt to increase butter prices. The Commission considered that the supermarkets could:
- threaten or impose sanctions on Fonterra across its portfolio of products, such as in those markets where Fonterra faces competition (e.g. yoghurt);
  - facilitate entry or expansion by existing or potential competitors through allocating shelf space and promotional spots; and
  - encourage contestability for the house brand contracts and tightly monitor contract performance. The threat of imports would give the supermarket operators further leverage and enhance this countervailing power.
364. In this instance, Tegel and Inghams both produce a range of further processed products such as chicken nuggets, chicken tenders and gourmet chicken products (e.g. chicken

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<sup>20</sup> Decision 574, *Fonterra / Kapiti Fine Foods*, 23 February 2006, Decision 562, *Fonterra Co-operative Group Limited/ New Zealand Dairy Foods Limited*, November 2005.

kiev). However, there is no more competition in respect of these products than there is for primary and secondary processed chicken.

365. The Commission considers it unlikely that Turks or Spring Chicken would have the [ ] incentive to expand to such an extent that they would provide sufficient competitive constraint. In addition, in respect of the sponsorship of entry, as discussed in the section on potential entry, the Commission considers that new entry into chicken processing on a significant scale is unlikely.
366. House brands represent a relatively minor proportion of a supermarket's chicken sales, and so it is unlikely that supermarkets could stimulate rivalry between Tegel and Inghams using this mechanism. The Commission also notes that as imports of fresh chicken meat are illegal in New Zealand, supermarkets are unable to use imports as a threat.

#### *Conclusion on Countervailing Power*

367. In summary, North Island supermarkets represent a significant proportion of chicken meat processors' total sales. However, in exercising any countervailing power, supermarkets need to be able to shift substantial volumes from one supplier to another. In the factual scenario, there would be only two players capable of processing such volumes and long lead times would likely to dampen any such threat. In addition, sponsorship of entry or expansion is unlikely and imports pose no competitive constraint.
368. Consequently, the Commission considers that in the factual scenario the countervailing power of supermarkets in the North Island is likely to be more limited than in the counterfactual.

#### **Constraints from Outside the Market**

369. The Applicant submitted that while there was insufficient evidence to conclude that meat such as lamb, beef, or pork are in the same market as chicken meat products, the price of chicken would still be constrained to a material degree by the price of other animal protein.
370. In the market definition section, the Commission considered other forms of animal protein to be outside of the market for chicken products. While the Commission acknowledges that some substitution occurs at the margin, it is of the view that the degree of substitution is unlikely to be sufficient to pose any significant constraint on the merged entity.

#### **Non-coordinated Market Power**

371. All downstream markets affected by the proposed acquisition are highly concentrated. In this type of market with a few firms having large market shares, it is inevitable that firms will recognise their interdependence, meaning that significant actions taken by one large firm will impact upon the others. A good example referred to above was when Inghams won the large KFC contract from Tegel. When Inghams expanded production to supply the contract, Tegel responded by [ ]
372. Recognition of interdependence, and of the risks of provoking adverse reactions from large rivals, is likely to cause firms to modify their behaviour. Examples of this were mentioned earlier (see paragraph [257]). It is not surprising that Tegel, when formulating its pricing and strategic decisions, focuses on [ ]

] The inference is that if it were to do this, and Tegel responded by holding its output constant, prices would drop and both would suffer, [ ]. It may be that such output-holding responses are a consequence in this industry of the exigencies of the upstream livestock supply part of the production chain, where, at least in the short-term, increases or decreases in the supply of DOCs can occur only gradually and with a time lag. All this is consistent with Tegel's comment that [

].

373. A complicating factor is the presence of Brinks. There have been numerous comments to the effect that Brinks is a low cost and vigorous competitor. Indeed, it has been described as the price leader, in that it sets lower prices than the two market leaders, to which they are forced to respond in order to retain the business. Without its presence, the market would be less competitive. Smaller firms that compete vigorously, such as Brinks, can upset firm interdependencies, forcing larger rivals to behave more competitively, and to set lower prices, than would be the case in their absence. By the same token, their removal by takeover would allow the industry duopoly to reassert itself, and be likely to cause output to be lower, and prices to be higher, than in the counterfactual where Brinks continues to compete.
374. In the factual, without Brinks, it is possible that Tegel and Inghams might compete in a way that would be expected in a workably competitive market, although this seems unlikely given their comments above. Rather, what seems more likely (assuming the absence of coordination, which is considered as an alternative possible outcome below) is that the two remaining processors, jointly holding well over [ ]% market share, recognise their interdependence, resulting in an outcome that would fall well short of workable competition in terms of output and prices. Models have been developed that help to show how this perhaps non-intuitive outcome—firms interacting competitively and without coordinating their pricing or other behaviour, yet market prices being above competitive levels—can come about.
375. Given that most chicken products are largely undifferentiated, and that supply responses are slow, the Cournot model might apply to the market under investigation here. This model is based on the following assumptions: the product produced by all firms is homogeneous; each firm sets its output quantity and allows the market to determine price; and each firm assumes others will hold their quantities constant when it adjusts its output to maximise its profits. This process leads to an equilibrium in which a single market price will prevail. This price will be above the competitive price, and the fewer the firms in the market, the greater that margin will be. This exertion of market power occurs even though the firms are competing, in the sense that each is seeking to maximise its own profits, but in the context where it assumes that other firms will hold their outputs unchanged when it sets its own output.

#### *Conclusion on Unilateral Effects*

376. The market at issue is highly concentrated, with the largest two firms—Tegel and Inghams—having a combined [ ]% market share and the balance being shared by three rivals (Brinks, Turks, and Spring Chicken). The proposed acquisition would reduce the number of major chicken processors in the North Island from three to two.

377. The Commission considers that, in the counterfactual, Brinks would continue to be a catalyst for lower prices and would continue to provide competitive tension in the market. In the counterfactual, this competitive would be lost.
378. In the factual, the combined entity's main competitor would be Inghams. While there is some evidence that Tegel and Inghams compete, there is also evidence that they do not compete to the extent that they could. The removal of Brinks in the factual is likely to further diminish that competition.
379. Both Turks and Spring Chicken are likely to remain smaller in scale than Brinks. In addition, [ ] the future success of Spring Chicken is uncertain. To this extent, the Commission considers that in the factual, Spring Chicken and Turks are unlikely to be able to restore the competitive rivalry that would exist in the counterfactual.
380. The Commission considers that in the factual scenario, entry into chicken processing is unlikely to occur on sufficient scale or in sufficient time to act as a constraint on the combined entity.
381. In the factual, any countervailing power of supermarkets is likely to be diminished, compared to the counterfactual. Further, other meat products are likely to provide very limited constraint on the price of chicken meat products.
382. In addition, due to the reduction in the number of players, the degree of interdependence between Tegel and Inghams would be significantly increased in the factual compared to the counterfactual.
383. The Commission has assessed the potential for unilateral market power to be exercised to the extent that a substantial lessening of competition would be caused when comparing the factual to the counterfactual. The Commission concludes that the potential for unilateral market power to be constrained by existing and potential competition and other possible constraints, such as countervailing power held by purchasers, would be lessened in the factual.

### **Removal of a Vigorous Competitor**

384. The Commission acknowledges that unilateral and coordinated effects have different underlying assumptions regarding companies' behaviour. However, the Commission is of the view that the removal of an independent competitor increases the risk of unilateral or coordinated effects being exercised. This is because reducing the number of competitors increases the unilateral market power of each firm, and also makes coordination among competitors easier.<sup>21</sup>
385. With a market share of [ ]%, Brinks is considerably smaller than Tegel and Inghams. However, the Commission considers that sometimes a market contains a firm that is in some way non-typical, or has different characteristics. As the Commission notes in its Merger and Acquisition Guidelines, the independent or less predictable behaviour of such a firm may be an important source of competition in the market. Such a business need not to be large to have an impact on competition out of proportion to its relative market size.

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<sup>21</sup> Section 9.1 of the Mergers and Acquisitions Guidelines.

## Coordinated Effects

### *Introduction*

386. The proposed acquisition would give rise to a reduction in the number of major suppliers from three to two in the North Island supermarket market, with Turks and Spring Chicken remaining as fringe players. Further, as discussed in the section on potential entry, there are significant barriers to entering the market on sufficient scale so as to act as a competitive constraint. Also, there are no imports of uncooked chicken products from abroad into New Zealand as this is illegal.
387. The Commission considers that there are a number of factors in this industry which might support coordination. These factors include;
- Brinks' role in the industry;
  - the cost structures of Tegel and Inghams;
  - the industry association PIANZ;
  - the ability to control industry output; and
  - the degree of co-operation and understanding in the industry.
388. Again, it should be noted that some the analysis presented below is generic and does not apply exclusively to the North Island supermarket market. This is because some coordinated outcomes could affect more than one market. Also, some coordinated outcome could be easier to achieve or maintained in different markets.

### *Factors Affecting Coordination in the Industry*

#### Brinks' Role in the Industry

389. As discussed in the section on unilateral effects, industry participants consider Brinks to be the price discounter in the market. Mark Baker of Foodstuffs Auckland advised the Commission that it was "concerned that the market will lose the discount leader". In addition, he stated that "Brinks are very good at keeping the market honest".
390. The Commission therefore considers that Brinks' behaviour serves to disrupt attempts at coordination. Hence its loss by acquisition is likely to allow conditions in which coordination could more easily occur.

#### Cost Structures of Tegel and Inghams

391. As outlined previously, the Commission attempted to assess the degree to which cost structures differ across suppliers but concluded that such analysis would be uninformative due to inconsistencies in the allocation of costs across suppliers.
392. In its Application, Tegel stated that:
- [ ]
393. Tegel further submitted that if cost structures and levels of efficiencies of firms were distinct, agreeing on a focal point for pricing and allocation of the spoils would be difficult, making coordination between these firms less likely.
394. However, Tegel also stated that:

The proposed acquisition will enable Tegel to close that gap {between its and Inghams costs and efficiencies} and improve Tegel's ability to compete with its main rival at a time when the industry faces a combination of rising costs, increased competition from substitutable meat products and heightened consumer sensitivity to food prices.

395. The Commission recognises that coordination is more difficult where firms have significantly different cost structures. However, the narrowing of this difference through the acquisition would reduce this hindering factor.

#### PIANZ

396. As mentioned earlier in the report, PIANZ represents the interests of the poultry processing and breeding companies.
397. Membership of PIANZ is voluntary, but processors represented on its board make up 99% of chicken production in New Zealand. The Association is comprised of executive members, affiliate members and associate members. In order to be appointed as an executive member, a chicken processor must process in excess of five million birds per annum. Presently, there are four board members comprising the CEOs of Tegel, Inghams, and Brinks who are executive members, and Ron Turk of Turks, representing smaller processors as an affiliate member. Only executive members have voting rights, and the chairmanship of the Board rotates between the executive members from Tegel, Inghams and Brinks. PIANZ is funded by a voluntary levy on bird numbers.
398. Prior to May 2007, the threshold for executive membership was three million birds processed. When the Commission asked Michael Rozen of Inghams, the present Board Chair, why the threshold was increased, Mr Rozen responded:
- It was changed because there was a discussion at the board about the decisions that affect the industry. Tegel, Brinks and ourselves, we represent 95% of the industry and we wanted to protect our right to actually have a say over some of the key decisions that were actually affecting the industry. There would be a decision to be made with regard to the way we deal with the Food Safety Authority over campylobacter – whether we would get general consensus and the amount of investment that would be required to make that happen.
399. In the factual scenario, the change to the threshold will mean that only Tegel and Inghams will be executive members of PIANZ and that they will alternate the Chair.
400. PIANZ Executive Meeting minutes reveal that production levels are frequently discussed at meetings. As the funding of PIANZ comes from a per bird levy on processors, in formulating budgets, some agreement must be reached as to the likely level of annual production. In addition, some analysis of output statistics appears to occur at the meetings.
401. In the past, senior staff of Tegel, Brinks, Inghams, and Turks have visited each others' plants on numerous occasions. [ ]

[

]



402. The Commission notes from the PIANZ Executive Meeting minutes of the past two years, [ ] As the funding of PIANZ comes from a per bird levy on processors, in formulating budgets, some agreement must be reached as to the likely level of annual production.

[

]

403. In addition, some analysis of statistics appears to occur at the meetings. For instance, the following extract is from the minutes of 22 May 2006:

[

]

#### Degree of Co-operation and Understanding in the Industry

404. Sales of chickens are made regularly between the competitors Tegel, Inghams and Brinks. Tegel advised the Commission that for the month of May 2008 and the beginning of June 2008, [

]. Tegel added that [

]. Tegel also advised that it supplies

Brinks with chickens.

405. As discussed above, on occasion, the major players have visited each other's plants. As such, Tegel, Inghams and Brinks are likely to have good knowledge of each other's capacity and operating costs. Furthermore, [

]. Accordingly, each of the three participants will have an even better understanding of each other's input costs.

406. As stated earlier, Andrew Stevens, Chief Operating Officer of Tegel also advised the Commission that it and Inghams follow the same strategy; “[

]”.

#### The Changeover of the KFC Contract

407. In 2004, Inghams won the tender to supply KFC with its chicken requirements. The KFC contract is for a [ ] term. The contract requires [ ] tonnes per week, comprising [ ] tonnes of fresh chicken and [ ] tonnes of further processed chicken products. Previously, Tegel had supplied KFC. In order to supply such a large volume of chicken, Inghams had to gradually ramp up production, beginning with increasing the number of birds grown.

408. [

]

409. Ron Turk of Turks informed the Commission that “Tegel started the price war and prices decreased by [ ]%-[ ]%”. Mr Turk further advised that for three years after this, [ ].

*Ingredients of Coordination*

410. In broad terms, effective coordination can be thought of as requiring three ingredients: the possibility of increased profits through collusion: the possibility of detection of non-adherence; a punishment mechanism and the scope for retaliation.

411. Table 6 and

412.

413.

414. Table 7 outline the Commission’s assessment of the market characteristics facilitating or impeding coordination in the relevant markets,

**Table 6: Scope for Coordinated Market Power**

<b>Factor</b>	<b>Applicant’s view</b>	<b>Commission’s view</b>
High concentration of sellers	Yes. Removes the largest fringe player-but important fringe competition from Turks, Spring Chicken and Santa Rosa remains.	Yes. Markets are already highly concentrated and the proposed acquisition would reduce major suppliers from three to two in the North Island markets.
Undifferentiated product	Yes in terms of primary, secondary and further processed products as well as branded and unbranded products.	Yes, in terms of the offering to supermarkets and food service markets.
Price inelastic market demand	No definite evidence on price elasticity.	A high level analysis using supermarket scanner data suggests that the price of chicken products increased, on average, by 40% between June 2006 and June 2008. Over the same period, volume sales of these products decreased by 17%, suggesting that prices of these products are inelastic.
Entry by new firms is slow	Spring Chicken demonstrated that entry is possible in less than 2 years. Partial entry would even need less time.	Entry by Spring Chicken took over two years to reach production of [ ] million birds. To get sufficient scale to be a competitive threat in the North Island supermarket market will take another [ ] months.
Few fringe competitors	3 fringe competitors in primary processing, namely, Spring Chicken, Turks and Brinks. Proposed acquisition removes largest of fringe competitors but others are able to expand their supply.	Turks and Spring Chicken are unlikely to undertake the step change in expansion required to compete effectively in the North Island supermarket market.

<b>Factor</b>	<b>Applicant's view</b>	<b>Commission's view</b>
Loss of an aggressive competitor	Tegel does not believe that Brinks is a innovative or vigorous competitor. Thus, the exit of Brinks is not a loss of an aggressive competitor or maverick.	Brinks is considered the price discounting leader in supermarkets by supermarkets and by other processors.
Static production technology	Even though technology may be static, there are changing regulatory compliance requirements and the volatile nature of input costs means that production costs differ. The volatile nature of input pricing makes it difficult to coordinate on price.	Each of the suppliers face the same regulatory changes and changes to input costs.
Presence of industry fora		PIANZ facilitates the sharing of a large amount of industry information. PIANZ publishes industry production figures and the Board agrees on production numbers.
History of anti-competitive behaviour		[ .]
Purchasers have countervailing power		With the loss of the price discounter, Brinks, supermarkets' countervailing power will be diminished.
Frequent sales	Frequent sales at multiple buying levels. However, they are also high value and large orders and house-brand contracts are tendered for and are for a 12 and 24 month period	Supermarkets place orders for varying quantities on a daily basis.
Stable, slow growth in demand	Moderate growth in demand for all players. Since the input costs shocks in increased input prices since 2006, consumption has dropped and customer demand is now in recovery mode but remains volatile. In this market scenario, all processors have an incentive to fight to retain share in a declining or changing market.	Although market demand has grown over the past five years or so, industry participants advised that market growth in respect of primary and secondary processed chicken is now almost mature.
Price transparency	No - prices are not published or available to competitors, and if prices were discoverable these are rarely followed in practice due to buyer negotiation and disruption by special promotional items.	Customers often reveal price offers in attempts to secure better deals.
Cost similarities between businesses	Considerable cost asymmetry between leading two firms. Brinks also operate under one of the highest cost-structures in the market. Cost of the key input (feed) is volatile.	The average costs of production and supply of chicken products by Inghams and Tegel are likely to converge as a result of the proposed acquisition.
Multi-market contact	Yes but different suppliers feature in the different customer segments	Yes.
Lack of vertical integration	Inghams, Tegel and Spring Chicken are all vertically integrated and Turks to a	Both Inghams and Tegel are fully vertically-integrated.

Factor	Applicant's view	Commission's view
	lesser degree.	

**Table 7: Ability to Retaliate**

Factor	Commission Assessment
Credibility of threats to abandon collusion and expand output should prices fall	The oversupply situation when [ ] is a credible mechanism and one that Tegel has demonstrated it is willing to use.
Availability of excess capacity in hands of non-deviating parties	Yes. Both Tegel and Inghams have excess capacity post acquisition.
Non-deviating parties have strong profit incentive to preserve the collusion	All parties have similar profit incentives.
Ability to disadvantage deviating business by dumping output in deviating party's market	Previous demonstration of over-supply.

*Conclusion on Coordinated Effects*

415. The Commission is of the view that there already exists a number of factors that are likely to facilitate collusion such as:

- PIANZ which may facilitate the sharing of output projections;
- Tegel and Inghams have considerable knowledge of each other's plants;
- parties in the industry appear to know each other's prices and would have a reasonable idea of each other's costs;
- demand appears to be relatively price-inelastic which enhances the scope for profitable price rises;
- fringe players face significant barriers to expansion and entry is unlikely; and
- the KFC over-supply situation demonstrated that spare capacity provides a mechanism for punishing deviation from coordination.

416. Post acquisition, the Commission is of the view that the removal of Brinks, the acknowledged price discounting leader, would remove the player that, in the counterfactual, would act as a destabilising influence in respect of any attempt by Tegel and Inghams to engage in coordinated behaviour.

417. To this extent, the Commission considers that the proposed acquisition is likely to materially enhance the scope for coordinated behaviour in the North Island supermarket market.

### **Quantifying the Effects of Different Competitive Conditions Across Markets**

418. The Commission considers that different degrees of competition across markets might be correlated with different levels of prices and/or margins in those markets. For example, if the degree of competition in market A was higher than in market B, prices and margins for comparable products might be lower in market A compared to market B. Analysing prices and/or margins across markets might therefore assist in testing and quantifying the effects of different competitive conditions across markets.
419. To this end, the Commission attempted to undertake a price comparison analysis using list prices provided by processors to its customers. However, the Commission found that list prices reflect to only a limited extent the actual price paid by a customer. This is because list prices tend to serve as starting points for price negotiations. Consequently, actual sales prices might differ significantly from list prices. The Commission therefore considers that a price comparison analysis using list prices would be uninformative.
420. The Commission also attempted to undertake an analysis of average sales prices. However, the Commission found that such prices might vary for a number of reasons other than the competitive conditions in a market. For example, average sales prices between supermarket and food service customers might vary because of differences in customers' size, and product mix. Similarly, average sales prices across food service providers in the North and the South Island might differ because of different production and input costs given the different sizes of the two islands. In both cases, the effects of varying levels of competition would be irreconcilably intertwined with other factors that affect average sales prices.
421. Finally, the Commission has attempted to undertake a margin analysis. However, processors, in particular Tegel, insisted that the required margin data did not exist.

### **Conclusion on the North Island Supermarket Market**

422. The Commission concludes that the proposed acquisition would reduce the number of large chicken processors in the North Island from three to two and that it is likely to
- remove an independent competitor that is a catalyst for lower prices and provides competitive tension in this market;
  - reduce the degree of supermarkets' already limited countervailing power;
  - increase the scope for the exercise of unilateral market power; and
  - increase the scope for coordinated behaviour.
423. Further, the Commission has doubts that these adverse effects on competition would be compensated by competitive constraints posed by the remaining competitors, Inghams, Turks and Spring Chicken, or the threat of potential competition, post acquisition.
424. Accordingly, the Commission cannot be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the North Island supermarket market.

## COMPETITION ANALYSIS – NORTH ISLAND FOOD SERVICE MARKET

### Existing Competition

425. The North Island food service market is characterised by a diverse range of customers who are supplied with primary and secondary processed fresh and frozen chicken meat products by Tegel, Inghams, Brinks, Turks, and, more recently, Spring Chicken.
426. Customers in this market fall within three broad categories:
- further preparers and smallgoods producers, such as Sam’s and Santa Rosa, who purchase predominantly fresh whole dressed birds in bulk from primary processors and then carry out the processing of those birds into value-added products. These processors in turn resell into small retail and distribution channels;
  - distributors of a wide range of food products such as Crean, who buy a range of finished or semi-finished chicken products from various primary and secondary processors and on-sell these products to smaller food service and retail customers; and
  - retailers, such as the Mad Butcher and other meat retailers who take largely unbranded, commodity chicken and do not buy volumes anywhere near those of supermarkets.
427. The Applicant submitted that it faces a significant degree of rivalry from Inghams [ ]. In addition, Tegel stated that Turks provides a degree of competition and that it also expects that Spring Chicken, once operating at optimum capacity, will also provide Tegel with competitive constraint.
428. Table 8 sets out the estimated market shares of processors supplying primary and secondary processed chicken meat to North Island food service customers. These figures are based on the value of wholesale sales in 2007.

**Table 8: Estimated Market Shares for the Food Service Market in the North Island 2007**

Participant	Value (NZ\$m)	Share (%)
Tegel	[ ]	[ ]
Brinks	[ ]	[ ]
Combined entity	[ ]	[ ]
Inghams	[ ]	[ ]
Turks	[ ]	[ ]
Spring Chicken	0	0
Total	[ ]	100

Source: Tegel, Brinks, Inghams, Turks, and Spring Chicken

429. Table 8 shows that in 2007, Tegel accounted for [ ] % of sales to the North Island food service market. This would increase to [ ] % in the factual and the three-firm concentration ratio would increase from [ ] % to [ ] % post-acquisition. This is outside the Commission’s safe harbours.

*Tegel*

430. Several food service customers advised the Commission that Tegel's prices tend to be above those charged for comparable products supplied by Inghams and Brinks.
431. [ ], Managing Director [ ] submitted that prices for chicken products vary regionally and that, on average, Tegel's prices are higher than Brinks'. Further, [ ] said that:
- Tegel and Inghams tend to operate together in regards to how prices move... Tegel tends to lead price rises, Inghams tend to follow closely behind and Brinks is the one that is the fly in the ointment; it tends to trade a bit more and keep them honest a bit more.
432. [ ], a North Island further preparer, described a similar pattern of price movements:
- they {Tegel} are usually the first one to do it{increase prices}. And then it will be followed by Inghams about two weeks later and then another two weeks later it will be followed by Brinks. ... That happens every time. We know the pattern.
433. [ ] also stated that although Brinks is the last processor to increase its prices, those increases are typically at a lower percentage compared to Tegel and Inghams.
434. With regard to negotiating prices, [ ] submitted that Tegel merely informs the company of proposed price increases and these price increases are not negotiable. In contrast, Brinks often negotiates on price.

*Brinks*

435. Industry participants advised the Commission that Brinks is an important competitor in this market. For example, Exquisite advised the Commission that Brinks is the cheapest supplier of fresh chicken meat products. Exquisite attributes Brinks' ability to offer lower prices than Tegel and Inghams to the company's smaller size and resulting lower overheads and flatter corporate structure.
436. As set out in the North Island supermarket market analysis, Inghams views Brinks as a "vigorous" competitor [ ].
437. Crean also described Brinks as the cheapest provider for some chicken meat products. Nigel Boswell of Crean, referred to a situation that arose in [ ] when Crean switched to Brinks in that area after [ ] increased its prices significantly, and Brinks offered more attractive prices.
438. Crean opined that Brinks is an important processor to the company as it creates competitive tension in the market. Mr Boswell stated that:
- [ ]

*Inghams*

439. As discussed in the North Island supermarket market, Inghams tends to [ ]. A number of food service customers have also described Inghams as a price follower.
440. As previously discussed, Inghams advised the Commission that, as a result of the KFC "price war", [ ]. In addition, Inghams stated that [ ] Brinks who Inghams described as a price leader in the market place.

*Turks*

441. With regard to Turks (and Spring Chicken), Tegel submitted that, in this market:
- these firms provide significant competition and are a real alternative to customers. This is due to:

- their ability to be flexible and meet the demands of smaller customers such as independent butchers; and
- their supply of commodity unbranded chicken meat to end-users who do not require the full marketing, service or product innovation package that Tegel or Inghams provide.

442. Turks submitted that it [ ]:

[ ]

### *Spring Chicken*

443. Industry participants have described Spring Chicken as currently not being a competitive force in this market. For example, [ ] of [ ] stated that:

I understand that they {Tegel} have said that there is a new entrant {Spring Chicken} coming into the market. We are aware of that entrant. But that is like Progressive saying there is a dairy opening up at the corner and they are a new entrant to the supermarket business. They are just such a small operation compared to what is already there.

444. Because of Spring Chicken's recent entry and unsteady start, the Commission has doubts regarding the future success of the company and therefore the degree of competitive constraint that Spring Chicken is likely to provide in the future.

### **Expansion of Existing Competitors**

445. As outlined in the North Island supermarket market, Inghams is well resourced to expand its output.

446. As for the North Island supermarket market, in the factual scenario, Inghams, and Turks could expand their output in response to a price increase. However, the Commission has doubts as to whether either party would do so because of [

]

### *Conclusion on Existing Competition*

447. The Commission considers that the proposed acquisition would reduce the number of major chicken meat processors in the North Island food service market from three to two. In addition, there are two smaller processors (Turks and Spring Chicken) in both the factual and counterfactual.

448. In the counterfactual, the Commission considers that the players' behaviour in this market is likely to be similar to the current situation. In particular, Brinks would continue to

- take the role of a lower prices provider;
- have a different cost structure than Tegel and Inghams that makes its behaviour less predictable; and
- contribute to the level of competitive tension in the market.

449. In the factual, Brinks would be removed from the market and its competitive behaviour and the consequences thereof would cease to exist.



450. In the factual, the combined entity's main competitor would be Inghams. While there is some evidence that Tegel and Inghams compete, there is also evidence that Inghams and Tegel have a strategy of a survival of profit, [ ] Turks and Spring Chicken process significantly fewer chickens. [ ]. Even though Turks and Spring Chicken are likely to have some spare capacity in their processing plants, it is unlikely to be sufficient for them to counteract the effects of a 5% to 10% price increase by the combined entity. In addition, the Commission is unsure of Spring Chicken's size in the future.

## **Potential Competition**

### *Conditions of Entry*

451. The Commission considers that the entry conditions discussed in respect of the North Island supermarket market are relevant when analysing the North Island food service market. The only major difference in respect of this market is scale.
452. Because of the smaller size of many food service customers compared to supermarkets, scale is unlikely to be so important in this market. For a few large customers in this market, such as the Mad Butcher, sufficient scale would be important. However, the majority of customers in this market could be individually serviced by a smaller processor.
453. The Commission considers that entry on a smaller scale might be easier in this market. In this regard, the Commission notes that there has been a past history of entrants commencing production on a small scale with the output generally sold to food service customers.
454. However, even though entry into this market might be more straightforward because scale is not as important, the Commission considers that the other significant barriers to entry would remain. Spring Chicken's difficulties in entering the market demonstrate the obstacles to effective entry.

### *Example of Entry: Spring Chicken*

455. Spring Chicken is an example of recent entry on a vertically integrated basis. Although the company had existing growers in place and secured production and other facilities in relatively quick time, it has taken the company over two years to enter production. Further the company has experienced [ ] financial difficulties, which required a financial rescue package, and it has experienced operational difficulties, including problems in commissioning the second hand plant. The company has also withdrawn from its poultry breeding operations because it was not [ ]]. Spring Chicken anticipates that it will spend over \$[ ] million to enter chicken meat production.

## **The "LET" Test**

456. In respect of extent of entry, the Commission considers that, given the relatively large number and small size of the customers in this market, it would not be necessary to enter on a large scale. Accordingly the Commission considers that entry into the North Island food service market on a smaller scale would be easier to achieve and sufficient in extent compared to entry to supply supermarkets.
457. As noted previously, the timeframe for entry into chicken processing is dependent on a number of factors. These include the time required to organise the establishment of a processing plant, obtaining consents, arranging for growers, and feed and livestock.

458. The experience of Spring Chicken indicates that entry can take over two years to achieve. This was assisted by the company already having growers in place and by securing production and breeding facilities and obtaining the resource consents relatively quickly.
459. In respect of likelihood of entry, the Commission has considered whether entry would be likely if the combined entity were to increase prices by 5% to 10%.
460. As for past entry, Spring Chicken is the most recent example of entry into the North Island, and before that, Turks entered chicken meat processing about ten years ago. Spring Chicken has secured a number of food service customers. However, it has had an unsteady start. Consequently, the company's future success may be uncertain.
461. The Commission considers that entry into the food services market is easier compared to entry into the supermarket market as it may require a lesser scale. However, other entry conditions would remain that need to be satisfied.

*Conclusion on the LET Test*

462. The Commission concludes that while entry into this market could be of a sufficient extent, it is unlikely to occur in a timely manner.

*Conclusion on Potential Competition*

463. The Commission concludes that entry into the North Island food service market is possible and that it would be more straightforward to enter this market than the North Island supermarkets market as scale is less important. However, new entrants would continue to face a number of other significant entry barriers. This is illustrated by Spring Chicken's entry into this market.
464. Overall, entry into this market seems possible, yet the Commission considers it unlikely that this is possible over a two-year time frame
465. The Commission therefore concludes that in the factual, the combined entity would face limited constraint from potential competition.

**Countervailing Power**

466. With regard to food service retailers, the Applicant submitted that:

{a}lthough general food service and smaller retail customers may not themselves enjoy the same level of countervailing power, distributors such as Crean, Countrywide or Gilmours have significant countervailing power because they are able to aggregate the purchases of their customer base.<sup>22</sup>

467. The Commission notes that food service providers are frequently small in size, each accounting for a relatively small proportion of a chicken meat processor's sales. The four largest food service providers/distributors that Tegel supplies in the North Island each account for approximately [ ]% of the companies' total sales of primary and secondary processed chicken meat products. In addition, there is a long tail of small customers.

468. [ ], Managing Director [ ], a food service provider [ ]

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<sup>22</sup> Tegel's Clearance Application paragraph 8.1 (q).

], submitted that, if the company could not avoid a price increase by switching supplier, it would pass on that price increase and/or lower its margin. [ ] submitted that

If the price is going up and the market is going up then that's fine as long as we can pass it on.

#### *Conclusion on Countervailing Power*

469. The Commission is of the view that the fragmentation and small size of North Island food service customers suggests that these players are unlikely to have countervailing power sufficient to constrain the combined entity.

#### **Non-coordinated Market Power**

470. As for the North Island supermarket market, the North Island food service market is highly concentrated, with the largest two firms—Tegel and Inghams—having a combined [ ]% market share, and with the balance being shared by two to three smaller rivals. In this type of market with a few firms having large market shares, it is inevitable that firms will recognise their interdependence, meaning that significant actions taken by one large firm will impact upon the others.

471. Further, as outlined with regard to the North Island supermarket market, recognition of interdependence might cause firms to modify their behaviour, resulting in lower levels of output and higher levels of prices.

472. The loss of Brinks as a vigorous competitor and major processor in this market is likely to increase the degree of processors' interdependence and therefore increases the risk of reduced output and higher prices.

473. However, the presence of the fringe players and the fragmented nature of the customers in this market might dampen this effect.

#### *Conclusion on Unilateral Effects*

474. The market at issue is highly concentrated, with the largest two firms—Tegel and Inghams—having a combined [ ]% market share and the balance being shared by three rivals (Brinks, Turks, and Spring Chicken). The proposed acquisition would reduce the number of major chicken processors in the North Island from three to two.

475. In the counterfactual, Brinks would continue to be the catalyst for lower prices and to create competitive tension in the market. In the factual, Brinks would be removed from the market and its competitive behaviour and the consequences thereof would cease to exist.

476. In the factual, the combined entity's main competitor would be Inghams. While there is some evidence that Tegel and Inghams compete, there is also evidence that they do not compete to the extent that they could. The removal of Brinks in the factual is likely to further diminish that competition.

477. Turks, a comparatively smaller supplier is [ ]. In the factual, the Commission is unsure whether Turks would be likely to counteract a 5% to 10% price increase by the combined entity.

478. Although Spring Chicken [ ], given its recent entry and unsteady start, the Commission has doubt about the degree of competitive constraint that Spring Chicken is likely to provide in the factual.

479. The Commission considers that in the factual, the combined entity would face limited constraint from potential competition.
480. North Island food service customers are unlikely to have countervailing power due to their fragmentation and small size.
481. In the factual, the loss of Brinks as a vigorous competitor and major processor in this market is likely to increase the degree of processors' interdependence, and therefore increase the risk of reduced output and increased prices. However, the presence of the fringe players and the fragmented nature of the customers in this market might dampen this effect.
482. The Commission has assessed the potential for unilateral market power to be exercised to the extent that a substantial lessening of competition would be caused when comparing the factual to the counterfactual. The Commission concludes that the potential for unilateral market power to be constrained by existing and potential competition and other possible constraints, such as countervailing power held by purchasers, would be lessened in the factual.

### **Coordinated Effects**

483. As for the North Island supermarket market, some market conditions seem to be conducive for coordinated behaviour. Factors increasing the likelihood of coordination in the factual include:
- Brinks is low price provider in the North Island-based food service market. It's removal will leave the less two evenly-matched competitive players Tegel and Inghams, accounting for [ ]% of this market, post-merger;
  - PIANZ may facilitate the sharing of information – Inghams and Tegel would be the only members with executive voting rights;
  - Tegel and Inghams might have different cost structures, pre-acquisition, as Inghams operations are more efficient. However, the cost structures of the two companies are likely to become more similar as Tegel realises efficiencies post acquisition;
  - Tegel and Inghams have considerable knowledge of each other's plants;
  - all parties in the industry appear to have a reasonable idea of each other's costs;
  - demand appears to be relatively price-inelastic which enhances the scope for profitable price rises;
  - there are no imports due to legislation; and
  - the over-supply situation in 2005/2006 demonstrated that spare capacity provides a mechanism for punishing deviation from coordination.
484. The Commission also considered other factors which might make collusion in this market more difficult:
- the fragmented nature of customers in this market will make it more difficult to monitor one another's behaviour and ensure that coordination is maintained;
  - cost asymmetries between the major processors in this market and the smaller processors, such as Turks and Spring Chicken; and
  - a fringe of smaller competitors with capacity to take sales from the coordinating firms might be enough to render coordination impossible or unsustainable.

*Conclusion on Coordinated Effects*

485. While concerns remain regarding processors' ability to coordinate on total industry output, coordinated behaviour in this market is likely to be more difficult to sustain in this market compared to the North Island supermarket market.

*Conclusion on the North Island Food Service Market*

486. The Commission concludes that the proposed acquisition would

- remove an independent competitor that induces lower prices and provides competitive tension in this market;
- reduce the degree of food service providers' already limited countervailing power;
- increase the scope for the exercise of unilateral market power; and
- increase the scope for coordinated market power.

487. Further, the Commission has doubts that these adverse effects on competition would be offset by competitive constraints posed by the remaining competitors, Inghams, Turks and Spring Chicken, foodservice providers' countervailing power, or the threat of potential competition.

488. Accordingly, the Commission cannot be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the North Island food services market.

**COMPETITION ANALYSIS – THE SOUTH ISLAND SUPERMARKET MARKET**

**Existing Competition**

489. The South Island supermarket market is characterised by two major customers:

Progressive and Foodstuffs. As with the North Island supermarket, Progressive negotiates prices and purchases all its products centrally at its head office in Auckland.

490. In 2007, Progressive purchased \$[ ] million worth of primary and secondary processed chicken meat products from Tegel for its South Island-based supermarkets.

491. Progressive also purchased primary and secondary chicken meat products from Brinks and Inghams, worth \$[ ] million and \$[ ] million, respectively. Inghams indicated that the majority of primary and secondary chicken products it supplies to Progressive are frozen and further processed.

492. As explained previously, Foodstuffs purchases products for its supermarkets through a central buying scheme. Additionally, individual supermarket stores in the Foodstuffs chain can purchase products directly from processors.

493. In 2007, Foodstuffs purchased \$[ ] million worth of primary and secondary processed chicken meat products from Tegel. In addition, Brinks and Inghams each supplied Foodstuffs with \$[ ] million and \$[ ] million worth of primary and secondary chicken meat products.

494. South Island supermarkets acquire chicken products from Tegel, Brinks, and to a far lesser extent, Inghams. Tegel and Brinks each operate a single plant in the South Island both of which are located in or near Christchurch.

495. All of the processors that operate processing facilities in the South Island also operate processing facilities in the North Island, but not vice versa. Inghams, Turks, and Spring Chicken do not operate any processing facilities in the South Island.

496. As discussed in the market definition section, the Commission notes that limited amounts of fresh chicken products are transported from the North Island to South Island-based customers on a regular basis.<sup>23</sup> Tegel and Brinks transport small volumes of chicken meat products from their North Island processing plants to supplement production at their respective South Island plants. Inghams supplies South Island customers exclusively from its North Island processing plant.
497. Table 9 below sets out the estimated market shares of processors that supply primary and secondary processed chicken meat to South Island supermarkets. These figures are based on the value of wholesale sales made in 2007.

**Table 9: Estimated Market Shares for the Supply of Primary and Secondary Processed Chicken Meat Products to South Island Supermarkets in 2007**

Participant	Value (NZ\$m)	Share (%)
Tegel	[ ]	[ ]
Brinks	[ ]	[ ]
<i>Combined entity</i>	[ ]	[ ]
Inghams	[ ]	[ ]
Total	[ ]	[ ]

Source: Tegel, Brinks, Inghams

498. Table 9 indicates that post-acquisition, the combined entity would have a market share of [ ] %, and that the three-firm concentration ratio would be [ ] %. This is outside the Commission's safe harbours.

#### *Tegel/Brinks*

499. In 2007, Tegel, the largest participant in this market, supplied each of Foodstuffs and Progressive in the South Island with \$[ ] million worth of primary and secondary processed chicken products. Tegel supplied around [ ]% of Progressive's chicken product requirements and [ ]% of Foodstuffs' requirements.
500. In comparison, Brinks, the second largest supplier in this market, supplied \$[ ] million worth of chicken products to Progressive and \$[ ] million worth to Foodstuffs. Brinks supplied around [ ]% of Progressive chicken product requirements and [ ]% of Foodstuffs'.
501. Progressive submitted that, in the South Island, there is competitive tension between Tegel and Brinks. For example, [ ]. In this regard, Progressive submitted that supermarkets will buy from Brinks to force a lower price on the other processors.
502. In 2007, a fire destroyed part of Tegel's South Island processing plant. An internal discussion document mentions [ ]
- [ ]
503. The internal papers also stated that:
- [ ]

<sup>23</sup> The focus in this instance is on fresh chicken meat products that are transported from the North to the South Island. This is because all processors that operate processing facilities in the South Island also operate processing facilities in the North Island, but not vice versa. Inghams and Turks do not operate any processing facilities in the South Island.

504. These comments illustrate that, despite its submission to the Commission, Tegel does consider Brinks to be a significant competitor in the South Island.

*Inghams*

505. Inghams entered the South Island in 2005 and has subsequently developed a relatively small presence with regard to supplying South Island supermarkets. Inghams, however, considers itself not to be a big player in the South Island as it currently supplies “insignificant” volumes to supermarkets and food service customers. Michael Rozen, General Manager, Inghams stated:

We traditionally found it very hard to break into the retail market {in the South Island}. Tegel seems to have a significant advantage in that camp.<sup>24</sup>

506. Inghams’ strategy in developing sales into this market has so far been directed primarily at [ ]. In respect of sales to Foodstuffs, Mr Rozen of Inghams stated that:

[

]

507. Alan Malcolmson, General Manager Retail Operations, Foodstuffs, described Inghams as offering chicken products on an ad hoc, rather than a regular basis. Mr Malcolmson further advised the Commission that [

]

508. Mr Malcolmson further advised the Commission that Inghams is not a strong competitor in the supply of fresh chicken meat products in the South Island:

Competition is far more extreme in the North Island than it is here {in the South Island} in fresh {chicken meat products}. It is because Inghams basically aren’t here... [

]

509. During the past 12 months, Inghams has increased its sales to Foodstuffs, albeit on a modest scale, by focusing on delivering into individual stores. This follows the introduction by Inghams of measures to improve its integrity of supply. These include employing an increased number of merchandisers, using a cross dock facility at Foodstuffs distribution centre in Christchurch, and by carrying a two to three day buffer stock at its Christchurch distribution centre.

510. Currently, Inghams is supplying [ ] PAK’n SAVE stores and [ ] New World stores in the South Island. However, its product range is very narrow in terms of primary and secondary processed poultry products. Both Inghams and Foodstuffs advised that [ ] of Inghams’ supply to Foodstuffs is fresh, size 16, whole dressed chickens and [ ]% of other chicken product, which include chicken kebabs and other further processed products which are not relevant to this analysis.

511. [

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<sup>24</sup> Inghams interview 13 June (39:12)

Rozen noted that “we had no presence at all in retail in the Progressive camp in the South Island and in fact in Progressive South Island we really have had no presence at all”.

512. The Commission notes, however, that Inghams has periodically supplied some fresh product to Progressive in the South Island. During 2007 Inghams supplied a small volume of chicken to Progressive in the South Island on a regular basis. However, [ ]:  
[ ]

#### *Other Suppliers*

513. Currently, neither Spring Chicken nor Turks is actively engaged in supplying on a regular basis chicken meat products into the South Island.

#### **Expansion of Existing Competitors**

514. Inghams submitted that, traditionally, it has found it difficult to penetrate the South Island market largely due to issues relating to speed of delivery and security of supply. Since it has taken on the supply to KFC restaurants throughout New Zealand in 2003, Inghams has made limited progress in achieving growth in its South Island sales beyond modest levels. For instance in that period it has only gained a [ ]% market share. Between September 2007 and September 2008, Inghams increased its sales from [ ] to [ ] tonnes per quarter. Inghams stated this growth resulted from the employment of sales support staff and an improved distribution system, including leveraging off its KFC fresh distribution and using Foodstuff SI’s fresh chicken distribution system.
515. The Commission notes that the [ ] tonnes of chicken products referred to by Inghams includes further processed as well as primary and secondary processed chicken products. For the reasons outlined in the market definition section, the Commission considers that primary/secondary processed chicken products form a distinct market from further processed products.
516. The Commission considers that Inghams has the ability to increase the throughput of its North Island processing plant. However, a North Island-based supplier, such as Inghams, would require a distribution centre in the South Island in order to meet supermarkets’ requirements in terms of security of supply, speed of delivery, and minimum shelf life. The Commission is of the view that even with a South Island distribution centre, Inghams could not regularly supply the South Island supermarkets with significant volumes of secondary processed products, due to minimum shelf life requirements. This argument has been addressed in greater detail in the market definition section of this report.
517. [ ]

518. Inghams deep chills chicken products (extending the shelf life by cooling down the product to -1dC) in order to supply KFC in the South Island. Mr Rozen advised the Commission that in order to supply South Island supermarkets with a greater range of fresh chicken products, he could deep chill the products to extend their shelf life. [ ]



]

519. Foodstuffs advised that it expects Inghams to increase its sales in the future. [ ] The Commission also asked Inghams what its strategy would be in the factual scenario, i.e. if Tegel were to acquire Brinks. Inghams responded:

[ ]

520. [ ]

]

### *Conclusion on Existing Competition*

521. The proposed acquisition would reduce the number of major competitors in the South Island supermarket market from two to one, with the merged entity having a market share of [ ]%.
522. In the counterfactual, the Commission considers that the players' behaviour in this market are likely to be the similar to the current situation. In particular, Brinks would continue to
- induce other processors to offer lower prices;
  - have a different cost structure than Tegel and therefore a less predictable behaviour;
  - be the only processor, apart from Tegel, with South Island processing facilities; and
  - maintain a level of competitive tension in the market.
523. In the factual, Brinks would be removed from the market and its competitive behaviour and the consequences thereof would cease to exist.
524. In the factual, the combined entity's only competitor would be Inghams. Inghams is currently supplying only limited volumes in a narrow range of products. North Island processors' ability to effectively supply South Island based customers from their North Island processing plant, is impeded by the limited shelf life of chicken products.
525. As for the North Island supermarket market, Brinks' operations in this market are considerably smaller than Tegel's. However, as outlined above, a vigorous competitor can have an impact on the market that disproportionate to its relative size.
526. In the factual, the only other chicken processor in this market would be Inghams. However, Inghams is likely to pose minimal competitive constraint on the merged entity, primarily because of the lack of South Island processing facilities.

### **Potential Competition**

#### *Conditions of Entry*

527. The Commission considers that the conditions of entry discussed in the competition analysis on the North Island supermarkets market are relevant when analysing *de novo* entry into this market. Similarly, the reasons outlined in the earlier analysis apply here.
528. One additional barrier to entry that applies to the South Island to a more significant extent is the South Island's smaller population, and therefore demand. This limits the potential for a South Island-based processor to reach sufficient scale.

529. There have been no examples of *de novo* entry into this market since at least year 2000. Brinks is the last entrant into the market but that was through acquisition of two existing players in Southland and Canterbury. Prior to that there had been entry by a number of small market participants, including Canterbury Chicken (in 1985), but none of sufficient size to compete for supermarket sales.

*The “LET” test*

*Extent of Entry*

530. The Applicant submitted that a North Island based processor could enter this market by supplying chicken products from the North Island. However, as previously discussed and as demonstrated by Inghams’ inability to expand to any extent in this market, the Commission considers that this is not feasible. Accordingly, any new entrant to this market would require a South Island based processing plant.
531. In its analysis on the North Island supermarket market, the Commission concludes that entry into this market would need to be on a sufficiently large scale to meet the volume requirements of supermarkets. However, the Commission notes that the size of the South Island supermarket market is considerably smaller than the North Island supermarket market.
532. As such, it is likely that entry into this market could be effected on a smaller scale as is evidenced by the relatively small size of Brinks’ South Island processing plant. Therefore, the Commission considers that entry into the South Island supermarket market could occur to an extent sufficient to constrain the combined entity.

*Timeliness of Entry*

533. For the same reasons discussed previously, the Commission considers that entry, even on a small scale, cannot be affected within two years.

*Likelihood of Entry*

534. The Commission has considered whether entry would be likely if the combined entity were to increase prices by 5% to 10%.
535. In terms of past entry into this market, the only recent example is Brinks. However, its entry was achieved through acquisition of two existing players in Southland and Canterbury respectively. Subsequently, Brinks has closed its Southland plant, and has centralised its South Island operations to its Canterbury facility.
536. Heuvels has commenced processing corn fed organic poultry from Brinks’ former processing plant in Southland. However, it is only producing around [ ] birds per week, and is concentrating on supplying food service customers with organic chickens which command a far higher price than standard chickens.
537. Further, the combined entity virtually would be a monopoly supplier in the South Island supermarket market, post-acquisition. As such, the threat of its response to entry of a new supplier is likely to be significant. Tegel has excess capacity and has demonstrated in the past, e.g. [ ], that it is willing to use it to lower prices in a market.
538. For the reasons outlined above, the Commission does not consider new entry to be likely even in the event of a 5% to 10% price increase.

Conclusion on "LET" Test

539. The Commission concludes that while entry might be effected in sufficient extent, it is unlikely occur in a timely manner. Further, the lower return on investment and the threat of incumbent response make such entry unlikely.

Conclusion on Potential Competition

540. For these reasons, the Commission considers that the combined entity is unlikely to face constraint from potential competition in this market.

**Countervailing Power**

541. The Applicant submitted that large supermarket retailers hold extensive countervailing power across most food categories. The Commission notes that as the Applicant did not define separate North Island and South Island geographic markets it did not distinguish between North Island and South Island based supermarkets.

542. In the South Island, sales to supermarkets represent a considerable proportion of Tegel's and Brinks' total sales in that island, as is the case in the North Island. Comparatively, Inghams' has much lower level of sales to South Island supermarkets.

543. The Commission asked Foodstuffs how it would respond if a chicken meat supplier proposed a price increase. Alan Malcolmson of Foodstuffs said that:

[

]

544. Mr Malcolmson further advised the Commission that chicken meat processors increased their prices significantly between 2007 and 2008. Mr Malcolmson said:

[ ]

545. The Commission then put a hypothetical example to Mr Malcolmson, where Tegel proposed a price increase of 10%. Mr Malcolmson stated that Foodstuffs [ ]. [ ]. Mr Malcolmson also stated that:

[

]

546. In order to exercise countervailing power, supermarkets must have a choice of provider. Given Inghams' limited sales to South Island-based supermarkets, and its limited ability to expand its presence in the South Island within a two year time frame, the Commission considers that, in the factual scenario, supermarkets would have no alternative processor to whom they could switch a significant volume of sales for primary processed products, and to a lesser extent, secondary processed products. Accordingly, this would diminish any countervailing power that South Island supermarkets' might otherwise have in the counterfactual scenario.

Conclusion on Countervailing Power

547. The Commission concludes in the counterfactual scenario, that South Island supermarkets exercise little countervailing power. In the factual scenario, any

countervailing power that they would be able to exercise is likely to be greatly diminished.

#### *Constraints from Outside the Market*

548. As for the North Island market, the Commission is of the view that other forms of animal protein are unlikely to provide any significant degree of constraint on the combined entity.

#### *Conclusion on Unilateral Effect*

549. The proposed acquisition would reduce the number of major chicken processors in the South Island food service market from two to one. The Commission considers that, in the counterfactual, Brinks would continue to be a catalyst for lower prices and would continue to provide competitive tension in the market. In the factual, this tension would be lost.

550. Inghams has a minimal presence in this market and is unlikely to be able to expand either in the factual or the counterfactual, primarily due to the company's lack of South Island processing facilities.

551. The Commission is of the view that the combined entity would face limited constraint from potential competition as entry into this market is unlikely to occur.

552. Further, the Commission considers that South Island-based supermarkets are unlikely to have sufficient countervailing power to offset unilateral effects, and there is limited constraint from outside the market.

#### **Removal of a Vigorous Competitor**

553. As for the North Island supermarket market, the Commission acknowledges that, with a market share of [ ]%, Brinks is considerably smaller than Tegel. However, the Commission considers that sometimes a market contains a firm that is in some way non-typical, or has different characteristics. As the Commission notes in its Merger and Acquisition Guidelines, the independent or less predictable behaviour of such a firm may be an important source of competition in the market. Such a business need not to be large to have an impact on competition out of proportion to its relative market size.

#### **Coordinated Effects**

554. Because Tegel would be the only player in this market in the factual, there would be no party with whom to coordinate in respect of competition within this market. However, Tegel being the only supplier in this market could give rise to coordination on a national level. This could take the form of agreeing total national output or settling into a situation where neither Tegel nor Inghams compete for the other's customers.

#### **Conclusion on the South Island Supermarket Market**

555. The Commission concludes that the proposed acquisition would reduce the number of chicken processors in the South Island from two to one and that it is likely to

- remove an independent competitor that is a catalyst for lower prices and provides competitive tension in this market;
- reduce the degree of supermarkets' already limited countervailing power;

- increase the scope for unilateral market power; and
- increase the scope for coordinated market power.

556. Further, the Commission has doubts that these adverse effects on competition would be offset by competitive constraints posed by the remaining competitor, Inghams, supermarkets' countervailing power, or the threat of potential competition.

557. Accordingly, the Commission cannot be satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening competition in the South Island supermarket market.

## COMPETITION ANALYSIS – SOUTH ISLAND FOOD SERVICE MARKET

### Existing Competition

558. Customers in the South Island food service market are supplied mainly by Tegel and Brinks. Inghams is not involved in this market in any major way. However Inghams does supply some frozen primary and secondary processed chicken, as well as further processed product.

559. Table 10 sets out the estimated market shares of processors that supply primary and secondary processed chicken to South Island food service customers. These figures are based on the value of wholesale sales in 2007.

**Table 10: Estimated Market Shares for the Supply of Primary and Secondary Processed Chicken Products to South Island Food Service Customers in 2007**

Participant	Value (NZ\$m)	Share (%)
Tegel	[ ]	[ ]
Brinks	[ ]	[ ]
<i>Combined entity</i>	[ ]	[ ]
Inghams	[ ]	[ ]
Total	[ ]	[ ]

Source: Tegel, Brinks, and Inghams

560. Table 10 indicates that presently, Tegel accounts for [ ]% of sales to food service customers in the South Island. This would increase to [ ]% in the factual. The three-firm concentration ratio would be [ ]%, post-acquisition. This falls outside the Commission's safe harbours.

561. [ ] stated that when it last reviewed its supply arrangements in [ ], Brinks offered to supply it at prices that were substantially lower than Tegel's. [ ] said it then presented Tegel with the opportunity to match Brinks prices, but it refused to do so in very strong terms. It is ['

.]

562. Although Brinks' disputed the magnitude of the price differential between its own market prices and Tegel's prices, it confirmed that its prices to food services customers, such as [ ], are lower. Brinks understands that its prices are between [ ] cents per kilo less than Tegel's.

563. [ ], a retailer of chicken products in the South Island, advised that it purchases chicken primarily from Brinks which is prepared to negotiate on price. [ ] also indicated that Brinks is the price discount leader in this market.

564. [ ]

565. Michael Rozen of Inghams told the Commission that:

[

]

566. [ ] advised the Commission that it buys some frozen chicken product from Inghams but not fresh chicken. It considers that there are security of supply issues (e.g. the Cook Strait ferries do not always sail), in sourcing fresh chicken from a North Island-based processor, and that the lead times for delivery are longer (two to three days) compared to overnight delivery from Brinks. Westmeat advised that it is difficult to forecast demand three days in advance.

567. [ ] also stated that it only procures frozen products from Inghams in the South Island. The reason provided is that orders are placed with [ ] on a daily basis and they need to deliver fresh products on the following day. Due to Inghams' location and different packaging method ([ ]), it is only possible to distribute Inghams' frozen products within the South Island.

568. [ ] stated that:

[ ] considers that neither Inghams nor any of the other North Island processors exercises any constraint over South Island processors. Those processors do not currently supply any fresh chicken into the South Island and given the logistical difficulties in them supplying South Island customers, [ ] believes that they cannot viably supply South Island customers.<sup>25</sup>

### **Expansion of Existing Competitors**

569. Inghams, the only remaining competitor in the factual, [ ], therefore, the combined entity would be largely unconstrained.

#### *Conclusion on Existing Competition*

570. The proposed acquisition would reduce the number of chicken processors in the South Island from two major players to one, with the merged entity having a market share of [ ]%.

571. In the counterfactual, the Commission considers that the players' behaviour in this market is likely to be similar to the current situation. In particular, Brinks is likely to continue to

- be a low price processor;
- have a cost structure different from Tegel and Inghams that makes its behaviour less predictable;
- be the only processor, apart from Tegel, with South Island processing facilities; and
- maintain a level of competitive tension in this market.

572. In the factual, Brinks would be removed from the market and its competitive behaviour and the consequences thereof would cease to exist.

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<sup>25</sup> [ ]

573. In the factual, the only other chicken processor in this market would be Inghams. However, Inghams is likely to pose minimal competitive constraint on the merged entity, primarily because of the lack of South Island processing facilities and intention to build or acquire such facilities in the future.

### **Potential Competition**

574. For the same reasons discussed in the South Island supermarket market, the Commission is of the view that entry into the South Island food services market is unlikely.

### **Countervailing Power**

575. The Commission considers that because of the fragmentation and small size of South Island based food service providers, these customers are unlikely to have countervailing power sufficient to constrain the combined entity.

#### *Constraints from Outside the Market*

576. As for the North Island supermarket market, the Commission is of the view that other forms of animal protein are unlikely to provide any significant degree of constraint on the combined entity.

#### *Conclusion on Unilateral Effect*

577. The proposed acquisition would reduce the number of major chicken processors in the South Island food service market from two to one. The Commission considers that, in the counterfactual, Brinks would continue to be a catalyst for lower prices and would continue to provide competitive tension in the market. In the counterfactual, this tension would be lost.
578. Inghams has a minimal presence in this market and is unlikely to expand either in the factual or the counterfactual.
579. The Commission is of the view that the combined entity would face limited constraint from potential competition and that entry into this market is unlikely to occur.
580. Further, the Commission considers that South Island-based food service customers are unlikely to have sufficient countervailing power to offset unilateral effects and there is limited constraint from outside the market.
581. The Commission has assessed the potential for unilateral market power to be exercised to the extent that a substantial lessening of competition would be caused when comparing the factual to the counterfactual. The Commission concludes that the potential for unilateral market power to be constrained by existing and potential competition and other possible constraints, such as countervailing power held by purchasers, would be lessened in the factual.

#### *Coordinated Effects*

582. Because Tegel would be the only player in this market in the factual, there would be no party with whom to coordinate in respect of competition within this market. However, Tegel being the only supplier in this market could give rise to coordination on a national level where processors agree on total national output or settle into a situation where neither Tegel nor Inghams compete for the other's customers.

#### *Conclusion on the South Island Food Service Market*

583. The Commission considers that the proposed acquisition would reduce the number of large chicken processors in the South Island from two to one and that it is likely to

- remove an independent competitor that is a catalyst for lower prices and provides competitive tension in this market;
- reduce the degree of food service providers' already limited countervailing power;
- increase the scope for unilateral market power; and
- increase the scope for coordinated market power on a national level.

584. Further, the Commission has doubts that these adverse effects on competition would be offset by competitive constraints posed by the remaining competitor, Inghams, food service providers' countervailing power, or the threat of potential competition.

585. Accordingly, the Commission cannot be satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening competition in the South Island food service market.

## COMPETITION ANALYSIS – QSR MARKET

### Existing Competition

586. The Applicant submitted that only Tegel and Inghams currently supply QSR customers, while Brinks, Turks and Spring Chicken do not and that as such, there would be no difference between the factual and the counterfactual.

587. In respect of KFC, the products supplied are large volumes of fresh chicken pieces of a standard size, chicken breast fillets of a uniform size, and further processed chicken products such as nuggets and patties. The remaining customers in this market, such as McDonalds and Burger King, require largely further processed chicken products.

588. Table 11 below sets out the estimated market shares of processors that supply secondary and further processed chicken to QSR customers on a national basis. These figures are based on the value of wholesale sales of primary/secondary and further processed chicken products.

**Table 11: Estimated National Market Shares for the Supply of Secondary and Further Processed Chicken Products to QSR Customers in 2007**

Participant	Secondary Processed		Further Processed	
	Value (NZ\$m)	Share (%)	Value (NZ\$m)	Share (%)
Tegel	[ ]	[ ]	[ ]	[ ]
Inghams	[ ]	[ ]	[ ]	[ ]
Total	[ ]	[ ]	[ ]	[ ]

Source: Tegel and Inghams

589. In the factual, no change is expected in these market shares.

590. In order to supply KFC, chicken processors require considerable scale which only Tegel and Inghams have. In respect of the other customers in this market, further processing facilities are required. Again only Tegel and Inghams currently have these facilities.

591. In order for a player to be considered a near competitor, it would need to be able to start supplying in the market within a one to two year timeframe. Brinks would be unable to satisfy this time requirement and as such is not an existing competitor in this market, nor would it be in the counterfactual scenario.

592. Accordingly, the Commission agrees with the Applicant that, since Brinks currently does not supply this market, there will be no difference between the factual and



counterfactual with regard to existing competition. However, the Commission considers that Brinks could consider supplying customers in this market in the future, making it a potential competitor.

### **Potential Competition**

593. The Commission considers that the most likely potential entrants into the QSR market are existing chicken processors such as Brinks, Turks and Spring Chicken. However, there are two main requirements for entry into this market: scale and further processing facilities.

#### *Scale*

594. The KFC contract is significant in terms of value as it accounts for approximately [ ]% of supply in this market. To this extent, KFC advised the Commission that KFC requires its suppliers to be large in size. KFC requires standard sized chicken products. In order to produce a sufficient number of equal-sized chickens, the processor needs to grow a large number of birds, and only a relatively small proportion of the chicken can then be sold to KFC as primary and secondary products.

595. Russel Creedy, Chief Executive of Restaurant Brands New Zealand Limited, franchisor of KFC restaurants in New Zealand, advised the Commission that, in order to supply KFC, a processor is required to have:

the ability to get rid of all the fringe of the bell curve birds {chickens that do not meet KFC's requirements} into supermarkets. To get rid of the small birds, big birds, leftover portions.... And if you don't have that market outfit, your bell-curve shape gets disturbed. Now that has always been the struggle in this industry. Every time we approached Inghams to become our supplier they were never big enough to supply us. Even though they could grow at that stage 20 million birds a year, it was not enough to get rid of the fringes of the bell-curve and they could not supply our volumes.

596. However, KFC further advised the Commission that it would consider allocating its supply requirements of chicken products to more than one processor. In 2003, when the KFC contract switched from Tegel to Inghams, KFC considered Brinks for the supply of around [ ]% of its requirements in respect of primary and secondary processed chicken, with Inghams supplying the remaining [ ]%. As KFC requires around [ ] million birds per annum, Brinks' share would have equated to round [ ] million birds.

597. While Brinks [ ].

#### *Further processing facilities*

598. QSR customers require further processed chicken products such as nuggets and patties. The processing of such products requires automated facilities which only Tegel and Inghams currently operate.

#### *Conclusion on Potential Competition*

599. The Commission considers that there are significant requirements for entry into this market because of the scale and further processing facilities required to do so. Further, Brinks, has advised the Commission it does not intend to enter this market. For these reasons, the Commission is of the view that the proposed acquisition would not result in a loss of potential competition in this market.

### **Conclusion on QSR market**

600. The Commission considers that currently, only Tegel and Inghams are competing in this market, entry by an existing processor is unlikely, and de novo entry is even less likely. These situations would exist in both the factual and the counterfactual.
601. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the QSR market.

### **OVERALL CONCLUSION**

602. The Commission has considered the likely competition effects of the proposed acquisition in the following upstream and downstream markets:
- Upstream markets:
    - i. the national market for the supply of chicken breeding stock;
    - ii. the North Island market for the supply of DOCs;
    - iii. the South Island market for the supply of DOCs;
    - iv. regional markets for the provision of chicken growing services; and
    - v. regional markets for the manufacture and supply of chicken feed.
  - Downstream markets for the wholesale supply of primary and secondary processed chicken products to:
    - i. North Island supermarkets;
    - ii. South Island supermarkets;
    - iii. North Island food service providers;
    - iv. South Island food service providers; and
    - v. QSR customers throughout New Zealand.
603. The Commission concludes that it cannot be not satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in the downstream markets for the wholesale supply of primary and secondary processed chicken products to:
- i. North Island supermarkets;
  - ii. South Island supermarkets;
  - iii. North Island food service providers;
  - iv. South Island food service providers.
604. However, the Commission is satisfied that the proposed acquisitions will not have, or would not be likely to have the effect of, substantially lessening competition in any of the upstream markets or the downstream market for QSR customers throughout New Zealand.

**DETERMINATION ON NOTICE OF CLEARANCE**

605. Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline clearance for the acquisition by Tegel Foods Limited of the assets and undertaking of the poultry business of P H Van den Brink Limited, VDB Industries Limited, Brinks South Island Limited, Southland VDB Limited and BAT Promotions Limited.

Dated this 22nd day of October 2008

Paula Rebstock  
Chair