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COMMERCE COMMISSION

Decision No. 544

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

SANFORD LIMITED

and

SIMUNOVICH FISHERIES LIMITED

The Commission:	Paula Rebstock David Caygill Peter JM Taylor
Summary of Application:	The acquisition by Sanford Limited (Sanford) of scampi quota of Simunovich Fisheries Limited (Simunovich)
Determination:	Pursuant to section 66(3) (a)/ (b) of the Commerce Act 1986, the Commission determines to give/decline clearance to the proposed acquisition.
Date of Determination:	26th January 2005

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EXECUTIVE SUMMARY

Proposed Acquisition

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 24 November 2004. The notice sought clearance for the acquisition by Sanford Limited (Sanford) of quota for scampi of Simunovich Fisheries Limited (Simunovich).

Market Definition

2. The Commission concludes that the relevant markets for this acquisition are those for:
   - the catch and domestic wholesale supply of scampi in New Zealand (the "scampi market"); and
   - rights to harvest scampi in New Zealand waters for export (the "scampi fishing rights market").

Counterfactual

3. The Commission is of the view that the appropriate counterfactual is the status quo.

Competition Analysis

4. The scampi industry has the specific characteristic of being regulated through the Quota Management System. This regulation means the quantity of scampi a market participant can catch is set by government, through allocation of quota, to accord with a Total Annual Commercial Catch. In a practical sense, quota translates an Annual Catch Entitlement (ACE), which then translates into tonnes per annum.
5. The scampi industry is also distinctive in that nearly all scampi caught in New Zealand waters is exported; only a small percentage of the total scampi catch is supplied to the domestic market as demand for the product is low in New Zealand.
6. In the present situation, existing competition constrains not in the usual sense of expansion of supply – given that quota limits supply – but rather through existing competition having the ability to divert export destined product to the domestic market, assuming the domestic price of scampi exceeds the export price.
7. While some [ ] the Commission is satisfied that [ ] there are enough potential buyers in the form of [ ] and fishers who need quota for by-catch reasons to step in as new entrants to constrain the combined firm.
8. Furthermore, given the small size of the domestic market – 5-10 tonnes annually – those competitors need only a modest amount of quota to be a constraint.

Although these competitors do need enough quota to make them commercially viable in terms of needing to compete in the export market. The amount required for commercial viability as a sole scampi fisher is approximately 80 tonnes, but this amount could be less if the fisher has a portfolio of other species in his/her fishing plan.

9. Therefore, the Commission considers that a combination of existing competition and potential competition would be likely to constrain the combined firm.

Overall Conclusion

10. The Commission is of the view that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the markets:

- scampi; and
- scampi fishing rights.

11. Therefore, the Commission has granted clearance for the acquisition by Sanford Limited of quota for scampi of Simunovich Fisheries Limited.

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PROPOSED ACQUISITION

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 24 November 2004. The notice sought clearance for the acquisition by Sanford Limited (Sanford) of quota for scampi of Simunovich Fisheries Limited (Simunovich).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice under s 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 27 January 2005.
3. The Commission's approach to analysing this proposed acquisition is based on principles set out in the Commission's Merger and Acquisition Guidelines.[1]

STATUTORY FRAMEWORK

4. Under s 66 of the Act, the Commission may grant clearances for acquisitions where it is satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]
5. The Commission considers that it is necessary to identify a real lessening of competition that is not minimal.[3] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.
6. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years.
7. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced service, quality or innovation, for there to be a substantial lessening, or likely substantial lessening, of competition, these also have to be both material and sustainable for at least two years.

ANALYTICAL FRAMEWORK

8. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening

[1] Commerce Commission, *Mergers and Acquisition Guidelines*, January 2004.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] See *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

- with the acquisition in question (the factual) ; and
- in the absence of the acquisition (the counterfactual).

9. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:

- existing competition;
- potential competition; and
- other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Sanford Limited (Sanford)

10. Sanford is an Auckland based fisheries company, listed on the New Zealand stock exchange. The principal activities of Sanford are harvesting, processing and marketing of seafood and farming, processing and marketing of aquaculture products. It harvests a wide variety of fish species.

Simunovich Fisheries Limited (Simunovich)

11. Simunovich is an Auckland based fisheries company, wholly owned by members of the Simunovich family. The principal activities of Simunovich are harvesting, processing and marketing of seafood, including scampi. Simunovich is now exiting the fishing industry. It has entered into a sale and purchase agreement with Sanford for the majority of its business assets, including scampi quota. Simunovich, however, retains its fish factory at 1 Market Place, and some associated berthage arrangements.

OTHER RELEVANT PARTIES

Amaltal Fishing Company Ltd (Amaltal)

12. Amaltal, one of the scampi quota holders, is a privately owned company based in Nelson. Currently Amaltal has six vessels in its New Zealand fleet. Amaltal’s operations extend internationally, and it has three other vessels owned by subsidiary companies: two longliner factory vessels and a further factory vessel operating in the Argentinean fishery. Amaltal targets deep sea species. The fish is able to be frozen and packaged on board.

Barine Developments Limited (Barine)

13. Barine is a small fishing operation and has one vessel. Barine markets the scampi it harvests under the ‘Sea Eagle’ brand to customers in mainly Japan and the USA.

Deadman & Lees (Deadman)

14. Deadman is a small fishing operation, which harvests and markets mainly inshore fishing. Although it holds scampi quota, [ ]

Petromont Holdings Limited (Petromont)

15. Petromont is a small fishing operation which targets scampi only, and has a small fish smoking operation. It has one 25 metre freezer trawling vessel, and employs nearly 20 people. Petromont markets its scampi mainly to overseas markets.

Vautier Shelf Company No. 14 Limited (Vautier)

16. Vautier is a scampi quota holder [ ]

Treaty of Waitangi Fisheries Commission – Te Ohu Kai Moana (TOKM)

17. TOKM was set up in 1992 to replace the Maori Fisheries Commission, established in 1989 to hold fisheries assets returned to Maori by the Crown, and to arrange for their eventual distribution. Scampi quota has been given to TOKM in trust to be distributed to iwi. The quota will be distributed to iwi as they qualify under legislative criteria. TOKM estimates the time period for distribution of scampi quota to be 2-5 years.

18. TOKM, however, have distributed most of the scampi ACE deriving from the scampi quota holdings to various iwi. ACE is discussed in the Industry Background section below.

INDUSTRY BACKGROUND

The Quota Management System (QMS)

19. The QMS was introduced in 1986, and controls the total commercial catch from all the main fish stocks found within New Zealand's 200 nautical mile, the Exclusive Economic Zone.[4] It was introduced to prevent overfishing and improve economic efficiency of the fishing industry. Major fishing grounds are divided into quota management areas. Most species now come under the QMS.

20. Scampi has only recently come under the QMS. From 1 October 2004 scampi was formally placed under the QMS regime. Under the QMS, New Zealand scampi fish stocks are divided into eleven quota management areas known as SCI1, SCI2, SCI3, SCI4A, SCI5, SCI6A, SCI 6B, SCI7, SCI8, SCI9, SCI10.

21. A certain number of quota shares were created per area. In the case of scampi, the number of shares per SCI is 100 million. These shares have been divided among fishers who could show a history of catching scampi. The quota shares the fishers are issued relates to the SCI where they have previously caught scampi, and the number of shares directly correlates to the volume of scampi the fishers have reported as catching previously.

22. Quota shares exist in perpetuity and are akin to a property right able to be sold, leased or disposed of. Quota shares cannot be transferred between SCIs. Quota gives holders another type of right called ACE. ACE is expressed in tonnes, and

[4] Following information sourced from www.seafood.co.nz

cannot be transferred between SCIs. The exact tonnage depends upon the Total Allowable Commercial Catch (TACC) set every year by Ministry of Fisheries.

23. A quota owner can elect not to fish at all, but rather lease their ACE to other fishers on a commercial basis. Leasing of ACE is generally done on an annual basis.

24. If a fisher is not one of the fishers originally issued with quota, and wants to target a fish species under the QMS, like scampi, they will either have to buy quota or lease ACE. Alternatively, some fishers may need quota or ACE for by-catch reasons, as all species that are caught, whether as a target or by-catch, that come within the QMS, must have the correlating quota or ACE.

25. A fisher who is catching by-catch and cannot or does not acquire ACE or quota, or a quota holder who has 'over fished' their quota and has not been able to lease ACE, must pay a 'deemed value' to the Ministry of Fisheries under section 76 Fisheries Act 1996. Deemed value is set higher than the port price to discourage fishers from over-fishing TACC limits by exceeding their respective ACE limits. On most species, the deemed value system works on a ratchet system: the more a fisher catches the more deemed value is raised above port price. The amount can rise up to 200 per cent.

Previous Scampi Management

26. For the purposes of context, it is useful to provide a brief outline of the history of the management of the scampi fishery in New Zealand.

27. Originally scampi fishing was completely unregulated apart from the requirement of a permit. Subsequently, the Ministry of Fisheries made moves to bring the scampi fishery under its management, so to that end the Ministry issued fishers individual catch entitlements (ICE) based on catch history. The New Zealand courts ruled that the provision of ICE was illegal and the scampi fishery returned to unregulated fishing, until it was brought under the QMS on 1 October 2004.

Scampi

28. Scampi itself is a crustacean, and has been described as a cross between a prawn and a crayfish. Scampi is fished with freezer trawler vessels, which are generally converted prawn trawlers. There is a healthy second hand market for these vessels, and they are also widely available for charter.

29. Once scampi is harvested from one of the SCIs, it is processed and packaged at sea, then marketed. Presently, all of these functions are performed by each market participant and so they all can be regarded as vertically integrated.

30. Scampi has a high port price: recent estimates put its value from \$24.00/kg to \$28.13/kg, depending on the grade. Most scampi harvested in the SCIs is exported to Japan and the United States. The small amount that is sold domestically is sold to restaurants and fish retail outlets.

PREVIOUS DECISIONS

New Zealand Seafood Investments Limited/Basuto Investments Limited – Decision 388 (Basuto)

31. In Basuto, the transaction involved New Zealand Seafood Investment Ltd (NZSI) acquiring 100% shares of Basuto Investments Ltd. Amaltal and Sanford were the entities behind NZSI. Sealord is the entity behind Basuto, as Basuto owned 50% of Te Ika Paewai Ltd (TIP) and TIP owned all shares in Sealord. Aggregation occurred and competition issues arose as a result of Sealord, Amaltal and Sanford all being fishing companies.

32. Due to various connections, that will not be elaborated upon here, the Commission considered Amalgamated Dairies, Sanford, Talley's and Sealord as associated in terms of section 47 Commerce Act 1986.

33. The Commission considered the likely impact of the proposal in a variety of markets including finfish, greenshell mussels, scallops, oysters and shellfish.

34. Basuto was decided before ACE was implemented into the QMS. A system of Individual Tradeable Quotas (ITQs) applied. These allocations were given in proportion to the historical catches of fishers, with those who had harvested the most getting the largest ITQs. The ITQs gave the owner the right to catch a certain tonnage of the TACC, in a given management area.

35. In terms of the competition analysis, the Commission recognised in Bausto that as the amount of TACC was set, the supply response of competitors was limited. In other words, the typical constraint of competitors to expand production and restrict the combined firm from raising prices and/or decreasing quality did not apply.

36. Instead, the particular size of the competitors quota relative to the domestic demand was relevant. The Commission considered that the extent to which the combined firm could exploit market power was likely to be capped as a result of competitive forces at play in the processing and wholesale markets, mainly through the possibility of export diversion and/or imports.

ASSOCIATION

37. The Applicant submitted various points with respect to refuting the potential for association, in terms of section 47 Commerce Act 1986, between Sanford and Amaltal, a scampi quota holder. The Applicants were seeking to misplace a previous finding made by the Commission in *Bausto*. In that decision, the Commission found that Sanford, Amalgamated Dairies Limited, Amaltal and Talley's Fisheries Limited were all associated with the Applicant, New Zealand Seafood Investments Limited.

38. Subsequent to the present Application, Talley's have bought out the Amalgamated Dairies Limited share of Amaltal making Talley's the sole owner of Amaltal. Consequently, there are no longer any common directorships that connect Amaltal and Sanford. The two companies are therefore not considered to be associated for the purposes of this Application.

MARKET DEFINITION

39. 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."[5]

40. For competition purposes, market participants include all those suppliers, and all those buyers, between whom there is close competition, and exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.

41. 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, 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 five dimensions outlined in the *Mergers and Acquisition Guidelines*. Only the product, geographic and functional dimensions are relevant to this application. The remaining two dimensions, temporal and customer, will not be discussed. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

42. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. For each initial market so defined, the Commission considers whether the imposition of a SSNIP would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market.

43. 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.

44. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

45. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

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[5] s 3(1) of the Commerce Act 1986.

46. The present application concerns acquiring the right to catch scampi, what this acquisition implies for the market for scampi in New Zealand, and how the acquisition affects the ability of scampi fishers to earn export income.

Scampi for local consumption

47. "Scampi" is the name given to crustaceans, *Metanephrops challengeri*, known elsewhere as Dublin Bay prawns (though scampi are not themselves prawns), as langoustines in France, and as Norway lobsters (*Nephrops norvegicus*). They are also marketed as "New Zealand lobsters", or as "New Zealand deep sea lobsters". Scampi are considered a delicacy. They provide a small quantity of meat per scampi, and are difficult to cook. The limits on the total annual catch and the demand for exports mean that New Zealanders consume a small quantity of scampi, relative to other kinds of food, and even relative to other premium types of seafood.

48. The parties submitted that "lobster, various slipper lobsters, crabs or prawns, or even certain finfish" were substitutes for scampi "at adjacent price/quality levels". The parties suggested that even if these types of seafood were not in the same product market, they nevertheless "exert a degree of competitive constraint on scampi".

49. In a nutritional sense, many other kinds of food may substitute for scampi. But scampi have few obvious substitutes as a gourmet food. Lobster and prawns are used similarly in cooking, and their taste and presentation is more similar to that of scampi than the taste of other foods might be. Other premium seafood (for example, abalone), and other rare or exotic food, may substitute from the point of view of offering the diner an uncommon experience, but they cannot offer the same experience. And one of the pleasures of consuming a delicacy food must be that it makes a singular appeal to the palate and to the other senses, an appeal that cannot simply be replaced by choosing another item that also happens to be on the menu.

50. Most of the firms that supply scampi to the New Zealand market also supply other types of fish. However, these companies cannot simply substitute other fish for scampi for two main reasons. First, quota and ACE are not transferable between species, and there are regulated limits on the amount of various other species of fish that they may catch (eg, hoki, tarakihi, orange roughy and snapper), and additional rights for other species can be difficult to buy. Second, industry participants have told the Commission that scampi fishing requires specialised equipment and labour. A ship fitted to catch scampi (a deep-sea creature) would need refitting to catch other species, and trained crew would need to be hired.

51. For the purposes of considering the competitive effects of the proposed acquisition, the Commission takes the conservative view that there is a market for scampi. The suppliers are the major fisheries, and the buyers are restaurants and households.

Scampi rights for export income

52. While fishers need ACE and quota to supply scampi to the local market, that is a small part of their business. The greater part of the value of scampi fishing rights comes from export earnings.

53. The rights to catch scampi are in two forms, quota and ACE. Quota confer a perpetual annual entitlement to catch scampi. ACE may be traded by a quota holder without relinquishing ownership over the quota itself. So, a quota-holder has four recurring choices:
    - to sell or retain quota;
    - sell or retain the right to catch the annual quantity of scampi implied by their quota (ie, ACE);
    - to lease quota; and
    - once trading options have been exercised, use or decline to use any residual ACE.
54. Holding scampi quota is uncertain in terms of the value changing. While it entitles the holder to catch a certain proportion of the total annual catch, the size and value of the total annual catch is uncertain, as is the cost of obtaining any given quantity of scampi.
55. A person who wants to catch scampi at any given time will choose between investing in quota or in an annual entitlement. Which instrument is preferable to any person will depend on a number of factors. These include:
    - current endowments in scampi quota;
    - personal discount rate;
    - expectations about scampi prices;
    - expectations about the costs of catching scampi;
    - the business' capital structure;
    - expected behaviour of competitors and buyers (local and overseas);
    - expected behaviour of quota- and ACE-holders; and
    - expected behaviour of the Government (i.e. will it issue further quota? how will it set the total catch entitlement in the future?).
56. Quota's value comes from the stream of income that it provides over time. This stream of income is realised by exploiting or leasing ACE derived from the quota. If fishing rights holders and buyers perceive the value of quota correctly, then the price of quota should equal the present value of the price of ACE in perpetuity.
57. One recent statistical study of the New Zealand fishing tradable quota found evidence that was consistent with the idea that the value of quotas should equal the present value of the stream of annual rights derived from quotas.
58. The Commission knows no reason why the values and prices of ACE and quota for scampi fishing should not relate to each other in the same way. For the purposes of assessing the competitive effects of the present application, the Commission will define a market for scampi fishing rights that includes ACE and quota.

By-catch

59. The foregoing defines markets in which scampi fishing rights are exploited by selling scampi locally or overseas. Another use for scampi fishing rights is to protect fishers of other species against penalties attracted by unintentionally

catching scampi. These fishers can manage the risk of catching scampi by purchasing an ACE or a quota. The quantity of scampi fishing rights held by fishers of other species is relatively small.

Functional Markets

60. The production, distribution and sale of a product typically occurs through a series of functional levels, conventionally arranged vertically in descending order. Generally, the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.

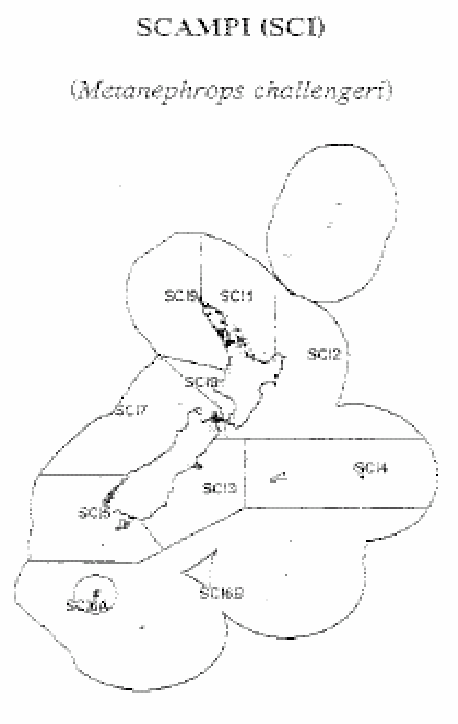
61. The proposed acquisition concerns scampi fishing rights. ACE and quota are inputs to fishers' final production. They are licences to do business; they permit the fishers to catch scampi that they can then bring to market. While these rights relate specifically to harvesting, they may affect other stages of production, such as processing and marketing. As these functions are generally integrated within fisheries, the Commission will consider the general effect of the proposed transaction on scampi harvesting and supply.

Geographic Markets

62. 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.

63. Scampi fishing rights are specific to eleven different regions around the New Zealand coast. To catch scampi in a particular area, fishers need rights for that particular area. The Government mandates how much scampi can be caught in each particular area.

Figure 1: Map of Management Areas for Scampi



64. The Commission has seen no evidence to suggest that consumers, either locally or overseas, value scampi caught in one region more or less than scampi caught in another. However, different densities of scampi that may be caught imply that costs differ by region. Consequently, scampi rights will be more valuable in regions where costs are lower for any given scampi market price, local or international.
65. The relative value of fishing rights in different regions may change over time, as the Government manages the catch.
66. The parties submit that the Commission ought to adopt a national definition, as it did in Decision 388.[6] In that decision, the Commission concluded that, although certain types of seafood might be more common in different regions because they were caught nearby, it was appropriate to define a national market, since fisheries transported fish around the country for processing and supply.
67. The Commission will consider the effects of the proposed acquisition on the national market. The Commission expects that any competition concerns raised by the acquisition are likely to be felt across all regions.

Conclusion on relevant markets

68. The Commission concludes that the relevant markets are those for:
    - the catch and domestic wholesale supply of scampi in New Zealand (the "scampi market"); and
    - rights to harvest scampi in New Zealand waters for export (the "scampi fishing rights market").

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[6] Commerce Commission, Decision 388: *New Zealand Seafood Investments Limited and Basuto Investments Limited*, 23 March 2000.

COUNTERFACTUAL AND FACTUAL

69. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[7] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

70. As a result of the acquisition, Sanford would acquire various New Zealand fishing rights and assets from Simunovich. The relevant item that Sanford would acquire for the purposes of this clearance is Simunovich's scampi quota holdings. The acquisition would make Sanford the largest holder of scampi quota.

Counterfactual

71. Simunovich has advised the Commission that if the proposed acquisition does not progress it still intends to exit the fishing industry and sell the scampi quota. The Commission considers there are two possibilities:

   - Simunovich's scampi quota could be acquired in total (or a significant portion) by another large player such as [ ]; or
   - Simunovich's scampi quota could be sold to a variety of players, including current scampi fishers, fishers wanting the quota for by-catch reasons or new entrants. Therefore, aggregation is less likely to occur and there would be more operators compared to the factual.

72. The Commission considers that the first scenario to be the most likely. Therefore, as the same number of players would be present in the market, the Commission considers the appropriate counterfactual to be the status quo.

COMPETITION ANALYSIS

Existing Competition

73. 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). Supply-side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

74. An examination of concentration in a market can provide a useful indication 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.

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[7] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

75. The Commission identifies market shares for all significant participants in the relevant market. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used.

76. In the present case, precise market share is difficult to state with certainty. To base market shares on quota holdings only would ignore the impact of a company who has leased in ACE, giving it the ability to increase the volume of scampi it can harvest. Alternatively, to base market shares on ACE only could be misleading to the extent that ACE is temporary in nature and ignores the significance of the perpetual rights associated with quota. Further, basing market share on volume only is not possible at this time as the QMS was implemented only recently (October 2004), and so a total reported catch is not available. Therefore, it is the combination of quota holdings and leased ACE which indicates market power. Accordingly, the two tables below outline each firm's share in terms of quota and ACE holdings.

77. The total volume of scampi sold in New Zealand is estimated to be approximately 5-10 tonnes annually. Given that the TACC for 2004-2005 is 1291 tonnes, the domestic market accounts for only a small proportion of scampi caught, the remainder being exported.

78. The Commission has been advised by market participants that not all scampi areas defined in the QMS are commercially viable. Exploration of areas SCI5, SCI6B, SCI7, SCI9 and SCI10 has shown that scampi is not present in high enough numbers to be commercially viable at this point in time. Therefore, the figures below are based only on areas SCI1, SCI2, SCI3, SCI4A and SCI6A.

Table One: Quota Holdings at 15 December 2004

FIRM	SHARES	PERCENTAGE
Sanford	192,251,120	24.11%
Simunovich	93,904,572	11.78%
Combined Firm	286,155,692	35.89%
Amaltal	8,098,960	1.02%
Deadman	18,672,235	2.34%
Barine	27,183,571	3.41%
Petromont	10,217,998	1.28%
Vautier	19,186,572	2.41%
TOKM	100,000,000	12.54%
Crown	33,457,473	4.20%
Other	8,207	0.00%
TOTAL	797,235,360	100.00%

Table Two: ACE Holdings at 15 December 2004

FIRM	TONNES	PERCENTAGE
Sanford	[ ]	[ ]
Simunovich		
Combined Firm	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
TOTAL	1,074,322	100.00%

79. Sanford is presently fishing Simunovich's entire ACE, and has leased [ ]

80. The Applicant submitted that the combined entity would be constrained from exercising market power by a number of factors. Firstly, any attempt by Sanford to raise price in the domestic market after the acquisition, would cause competitors to respond by diverting scampi destined for export. The Applicant submits that most scampi exported by smaller participants are sold to overseas spot markets, rather than under long term contracts.

81. Secondly, the Applicant submits if a genuine domestic market for scampi were to emerge in New Zealand, it could be serviced by importing cheaper Northern Hemisphere scampi in bulk. The Applicant submits that market supply from the Northern Hemisphere is substantial, and gives the example of the Scottish fishery being 15,000 tonnes annually, as well as suggesting that there are a number of other sizeable fisheries.

How competitors constrain in a 'managed' market

82. In considering the market shares as an indicator of the ability of the combined firm to exert market control, reliance is implicitly placed on the ability of competitors to respond to any increase in price. However, as part of the QMS a TACC is set; this means that capacity to supply the scampi market is also set such that the TACC has the effect of limiting the supply response of other competitors in a situation where one company, having aggregated quota, seeks to exploit its potential market power by restricting output and raising prices.

83. Normally, the output-restricting power of such a company would be limited or nullified by the ability of others to expand production, thereby maintaining market supply. This is not possible with scampi harvesting, where the output of rival companies is absolutely restricted by the quota system (unless their quota was to some extent undercaught, thus allowing them to expand production within existing quota holdings).

84. Instead, in the present situation, the competitors' ability to constrain derives from the ability to divert export product into the domestic market. If there were a

duopoly post merger, for example, conventional analysis might suggest that in the absence of an import constraint, firms' independent behaviour would serve jointly to restrict domestic supply below the competitive level, and to keep price above the export level (although below the domestic monopoly level).

85. However, given the characteristics of the scampi market, it seems likely that such unilateral (non-coordinated) market power would not arise. This is because both firms would have an incentive to divert export supplies to the domestic market should the domestic price rise above the export price. In other words, because both would no doubt be operating in both domestic and export markets, and the export market is competitive, any ability to exercise market power by independent action in the domestic market would be undermined by 'export diversion'.

86. It seems reasonable to conclude that post-merger, unilateral market power would be unlikely to emerge providing that scampi supplies in the hands of independent operators were sufficient to provide for export diversion (for example, the independents would not be supplying only the domestic market, and their export supplies would not be contractually committed).

87. Moreover, given that the New Zealand market for scampi is only 5-10 tonnes annually, competitors able to divert export destined scampi into the domestic market would not need to be large. In this sense then, *tonnage* by way of quota/ACE becomes a more accurate measure of power than *percentage*.

Current Market Participants

88. Given the small number of market participants in the scampi market, the Commission is able to examine the extent to which each participant may constrain the combined firm.

Amaltal

89. Amaltal's quota amounts to approximately 25 tonnes per year. Amaltal utilises approximately 5 tonne of its scampi quota for by-catch, [ ]. If the scampi is in reasonable condition, Amaltal may sell it to local restaurants or, if a significant number of scampi is caught, it may sell to the Japanese market. [ ] Therefore, Amaltal provides a limited constraint only.

Deadman

90. Deadman currently [ ] Deadman does not constrain the combined firm. Deadman is anticipating holding on to its quota for the foreseeable future and leasing it out.

[ ]

91. [ ]

92. [

]

TOKM

93. TOKM informed the Commission that most ACE has been distributed to approximately 58 iwi throughout New Zealand. TOKM said that given that scampi is new to Maori, it is unlikely iwi will seek to target it. This may mean that some iwi will choose to lease their ACE. However, if an iwi chooses to target it, TOKM said the amount each iwi gets will not be enough to sustain a commercial operation by itself and that iwi will either have to gain more ACE or quota, or join forces with another iwi or existing scampi fisher. [ ] Overall, because there is no history of trading or development in scampi for iwi, it is unclear at this stage whether iwi scampi ACE holders will be a constraint upon the combined firm.

By-Catch Fishers

94. As referred to above in relation to Amaltal, by-catch may be sold either domestically or for export. However, the volume sold from by-catch fishers is small as the quality of scampi is usually poor, given its tendency to get crushed in the rest of the catch, and because it is necessary to freeze and package the scampi on board. By-catch fishers, therefore, provided only a very limited constraint on the combined firm.

Barine

95. Barine informed the Commission that prior to implementation of the scampi QMS it was operating a viable business as fishing for scampi was largely unregulated. Barine was catching approximately [ ] tonnes per year. Given this viability, Barine provided a competitive constraint upon the other scampi fishers, including the largest quota holder at that time – Simunovich. Barine told the Commission that with the implementation of the scampi QMS in October 2004, [ ] Barine's quota has been set at approximately 65 tonnes, [ ] Barine presently provides some constraint on the combined firm, [ ]

Petromont

96. Petromont is [ ] When the scampi fishery was unregulated, Petromont was catching approximately [ ] tonnes per year. Since the implementation of the QMS, Petromont's quota has been set at 30 tonnes. [ ]

[ ]

Acquiring Quota/ACE

97. [ ] have advised the Commission that [ ]

98. [ ] single vessel operators [ ] would need between 80 – 100 tonnes throughput annually to remain viable, and are [ ] allocation of quota. The Commission has confirmed with other market participants that 80 – 100 tonnes would be necessary to sustain a single vessel operation. [ ]

99. [ ]

100. Dealing with quota first, sources of scampi quota are limited to potentially buying from a competitor, iwi and the Crown. While TOKM has quota allocated to it, that quota is held in trust by TOKM until such a time as iwi meet certain legislative criteria. The Commission has been informed by TOKM that the iwi quota is expected to be dispersed to individual iwi in 2 – 5 years. Therefore, the TOKM quota is not considered as a viable source for the purposes of this investigation.

101. The Crown possesses quota which it expects to put out for tender, although no date has been specified. Further, industry participants have informed the Commission that the only Crown quota worth acquiring is that in SCI3 and SCI4, as the remaining SCI areas in which the Crown holds quota are not commercially viable. Given the uncertainty as to when the Crown may put SCI3 and SCI4A for tender, whether this is a viable source of quota for a scampi fisher wishing to expand is equivocal.

102. It may be possible that [ ] to gain access to scampi quota. This would have the effect of forming a [ ] competitive constraint, [ ] While this would [ ] it would create a [ ] viable competitor.

103. In terms of ACE, a scampi fisher could lease ACE from iwi, the Crown or another competitor, although the Commission notes that leasing ACE is less desirable than acquiring quota given the temporary nature of ACE ownership. As discussed above, [ ] In the future leasing ACE from iwi may be an increased possibility given the initial view of TOKM that iwi are unlikely to target scampi. However, this availability comes with the rider that only the ACE in the viable commercial areas is desirable.

104. Currently, some Crown ACE is leased on an annual basis to [ ]

105. Demand for scampi ACE is currently very high, driving up the price. For instance, firms wanting it for by-catch reasons are willing to pay high prices given the high price of the deemed value (discussed in the Industry Background section). Sanford has also shown great interest in acquiring scampi quota and ACE, [ ] given its

position as New Zealand's second largest fishing operation. The high price of ACE may present a barrier for the likes of [ ] given their modestly sized operations.

Diversification of existing operations

106. Industry participants told the Commission that to dedicate a fishing operation to a single species, rather than have a plan to fish a number of species across a year, was virtually a non-existent approach by the fishing industry, and that scampi fishers appear to be the only group to do that. Independent Fisheries advised the Commission that most trawling or netting fishing operations are 'method fishers'. For instance, a method fisher will target tuna during the summer, then dredge for scallops and/or oysters during the winter. Simunovich suggests a scampi fisher could supplement his/her catch, and achieve similar margins to scampi, by targeting rock lobsters, becoming a paua diver, or targeting orange roughy.

107. The high value of scampi means only a small number need to be caught before an operation generates a significant revenue stream, unlike other species like hoki where high volumes are necessary before sufficient returns can be realised. Prior to the QMS, there was little incentive for the fishers [ ] to develop fishing plans to harvest a range of fish, given the high-value, low volume characteristic of the scampi market.

108. There appears to be some diversification already [

]

109. Industry participants informed the Commission that no substantial quantities of any species, other than scampi, can be caught whilst the vessel is set up to catch scampi.

110. However, it may be possible that a vessel can be converted to enable it to catch other species either before or after the scampi has been harvested.

111. For instance, a 25 metre freezer trawling vessel set up for scampi trawling can be converted either for in-shore or mid-water fishing.

- Cost of converting the vessel for in-shore fishing capabilities is approximately $50,000 – 60,000.
- Cost of converting the vessel for mid-water fishing capabilities is approximately $90,000 – 100,000.

112. The time frame for both conversions is one month.

113. Possible in-shore species include snapper, tarakini, baracouda and gemfish. Possible mid-water species include hoki, orange roughy and alfonsino.

114. The approximate cost of ACE per tonne for some of those species are as follows:

- Hoki – $300;
- Tarakihi – $2000;
- Orange Roughy – $25000; and

- Snapper – $4000.

115. According to Petromont, obtaining the ACE of the most profitable fishing species ranges from difficult to virtually impossible, unless a firm has a large quota holding or an affiliation with a large fishing company with substantial quota stock.

116. Industry participants advised the Commission that scampi crew are specialised and cannot be utilised in relation to other species. Therefore, new crew would need to be employed to catch other species.

117. Overall, the Commission considers that expansion of existing operations by sole scampi operators could be possible, although it recognises that access to ACE may be a restriction.

118. [ ] substantial player constraining the combined firm. Such a scenario assumes that [ ] and it cannot be certain that this would be the case as there are other potential buyers.

119. [ ] indicated it desires to [ ] thereby demonstrating it is a likely bidder for scampi quota.

120. [ ] advised the Commission that [ ] if it were available. Moreover, given that [ ] it is in a prime position to [ ]

121. Another potential significant group of buyers are those fishers who need quota/ACE to cover their scampi by-catch. Given the high deemed values they currently pay, they are incentivised to pay and bid high for scampi quota or ACE.

122. The Commission is therefore satisfied that [ ] there are potential buyers and that Sanford is by no means the only likely candidate to acquire scampi quota when and if it should become available.

123. Further, should Sanford wish to acquire more scampi quota, it would need to seek Commerce Commission approval. The Commission would then assess a new Application on its facts and determine whether further aggregation is likely to lead to a substantial lessening of competition.

Imports

124. In terms of imports, the Commission has been unable to identify potential entry by way of imports. This is probably due to the small size of the domestic scampi market and corresponding lack of demand.

125. The Commission consider it unlikely that the size of the scampi market will grow large enough within the next two years so that an off-shore supplier would be sufficiently incentivised to enter New Zealand. Therefore, the Commission does not consider scampi imports to be a realistic possibility and hence the threat of imports provides no constraint on the combined firm.

Conclusion on Existing Competition

126. The Commission considers on balance that existing competition – by way of being able to divert export product into the small domestic market – combined with the potential entry in the form of [ ] and by-catch fishers, would be likely to constrain the combined entity. The Commission therefore concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the national markets for:

- the catch and domestic wholesale supply of scampi in New Zealand; and
- rights to harvest scampi in New Zealand waters for export.

Co-ordinating Market Power

127. An acquisition may lead to a change in market circumstances such that either co-ordination between the remaining businesses is made more likely, or the effectiveness or pre-acquisition co-ordination is enhanced. The Commission is of the view that where an acquisition materially enhances the prospects for any form of co-ordination between businesses in the market, the result is likely to be a substantial lessening of competition.

128. The Commission evaluates the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for co-ordination would be materially enhanced by the acquisition. In broad terms, effective co-ordination can be thought of as requiring three ingredients: collusion, detection and retaliation.

129. Collusion involves businesses in a market either each individually coming to a mutually profitable expectation as to co-ordination (tacit collusion), or together reaching agreement over co-ordination (explicit collusion).

130. Detection requires that businesses that would deviate from the likely co-ordination are able to be swiftly detected by the other market participants involved.[8]

131. Deviations from the terms of co-ordination need to be not only quickly detected by the other suppliers, but also the deviating firm needs to be faced with a credible threat of swiftly being punished. The threat of retaliation increases the cost of deviating, thereby reducing the short-term profit to be gained by the business from deviating, and helping to preserve the co-ordination.

132. Co-ordinated market power could emerge amongst two or more oligopolists in the scampi market. Co-ordination could be effected by a duopoly agreeing to limit domestic supply in a manner akin to that of the monopolist, in order to keep up the domestic price. This would involve setting the quantities that each could supply to the domestic market. Export diversion would not pose a difficulty, providing all producers were party to the arrangement, and all adhered to its terms. However, given the preponderance of export supply, any maverick not party to the collusion (or any party who cheated on the arrangement) could have a considerable undermining effect by diverting its export supply to take advantage

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[8] Stephen Martin, Industrial Economics: Economic Analysis and Public Policy (2nd edition), New York: Macmillan, 1994, ch 6.

of collusion-induced higher prices in the domestic market. This suggests that collusion would be more than usually subject to risk of failure.[9]

133. While co-ordinated market power may be possible, it is likely to be difficult to sustain given the range of operators involved and the potential for export diversion.

OVERALL CONCLUSION

134. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:

- the catch and domestic wholesale supply of scampi in New Zealand; and
- rights to harvest scampi in New Zealand waters for export.

135. The Commission considers that existing competition would be sufficiently incentivised to divert export supplies to the domestic market, assuming the domestic price of scampi rises above the export price. That factor, when combined with potential entry in the form of [ ] and by-catch fishers, would be likely to constrain the combined entity. The Commission therefore concludes on balance that there are sufficient constraints on the combined entity from exercising market power in the above markets.

136. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition, in the markets for:

- the catch and domestic wholesale supply of scampi in New Zealand; and
- rights to harvest scampi in New Zealand waters for export.

[9] The analysis assumes that all Quota is fished by the owners. However, introducing ACE lease fishing would complicate the analysis in at least three possible ways: it might increase the number of fishers who would need to be party to the arrangement for it to be effective; the identity of the fishers might change frequently, as the leases were traded; and it would raise the average price of the Quota and ACE to reflect the greater profits being earned. The first two at least might further hinder the attempts at collusion.

DETERMINATION ON NOTICE OF CLEARANCE

137. Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Sanford Limited of scampi quota of Simunovich Fisheries Limited.

Dated this day of February 2005

Paula Rebstock

Division Chair

Commerce Commission