

To: Ms. Ainslee Wilton  
Office of Fair Trading  
Principal Case Officer, Mergers Branch  
Fleetbank House  
2-6 Salisbury Square  
London EC4Y 8JX

30 June 2006

Dear Ms. Wilton,

As you are aware, the price of farmed salmon has risen significantly in the last year. One explanation is that consumer demand has intensified. In economic terms, the demand curve has moved to the right, and with finite supply for farmed salmon (a relatively steep supply curve), price rises dramatically. This explanation is borne out by various stagnating export and import figures (tonnage) and news accounts. Farmed salmon requires roughly two years from egg to slaughter. That is, producers must forecast demand approximately two years ahead.

The market has matured with double-digit changes in volumes (law of small numbers) giving way to more mature, less volatile patterns. The industry has learned better how to forecast. And if demand rises enough, new entrants will provide additional supply. Several commentators, such as a Rabobank analyst, have proffered this explanation.<sup>1</sup>

With this theory, competition authorities may conclude that the market remains competitive; prices will moderate as supply is eventually increased to meet demand.

There are weaknesses, however, with essentially every part of this explanation.

Has consumer demand for seafood intensified? The price of other luxury seafood, namely shrimp, which also requires more than a year to produce, has not increased.

It is not consumers who are currently paying the largest percentage increase in price for farmed salmon, but the retailers, according to some reports. That is, producers are asking higher prices for the same product.

Has production fallen, or failed to keep pace with rising demand? While some sales volumes have fallen, some have increased. A Russian ban instituted since late 2005 would suggest a supply of unforeseen product available for the rest of Europe. Russia had been a growing market, and became Norway's largest salmon export target in 2005, absorbing some 40,000 metric tons of farmed salmon, about eight percent of total production. It would seem that selling that product elsewhere would dampen prices in a free market. (Reports of indirect, illegal shipments to Russian are noted.)

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<sup>1</sup> *IntraFish*. 27 June 2006. Quote by Rabobank Food and Agriculture Analyst Gorjan Nikolik.

It is not in industry's interests to increase supply to moderate price, only to maximize EBIT, from the (price multiplied by sales) minus (cost of goods) equation.

Will higher prices draw new producers? With the exception of Chile, legal barriers to entry seem solid, with little new production permitted. In Chile, production that once escalated by double digit figures annually has now subsided and in some years has declined.

There is a second explanation to rising prices: Consolidation leading to pricing discipline. In the last two years, four of the six largest producers have combined into one firm. Marine Harvest and Stolt merged and were, in turn, bought by Pan Fish, which then also purchased Fjord Seafood. Now, one company—Pan Fish—effectively controls more than 30% of production. In the United Kingdom, Pan Fish controls some 50% of production. In Chile, it controls about 30% of production.

Can competition authorities ignore the possibility that this recent price rise, and future farmed salmon prices, will be controlled to the detriment of consumers?

In this letter, we compare the history of consolidation in the farmed salmon sector with rising prices. We also begin to highlight the situations where major producing regions have decreased exports this year. And lastly, we offer some evidence that reduced competition and higher prices may persist as there are significant barriers to entry in this market.

As the Office of Fair Trading determines whether to subject the merger of Pan Fish, Marine Harvest and Fjord Seafood to further review, we ask you to consider whether these rising prices for farmed salmon are related to this consolidation of the farmed salmon industry.

## **Rising Prices**

There is no dispute that farmed Atlantic salmon prices have risen to unprecedented levels this year. On 19 May 2006, *IntraFish* reported that farmed salmon spot prices have reached the highest level in thirteen years (since 1993). Furthermore, this industry news publication stated these high prices are a result of “lower production from Pan Fish and Mainstream [Cermaq].”<sup>2</sup>

And, on 19 June 2006, *IntraFish* reported that “Norwegian farmed salmon prices were reaching between NOK 45 - NOK 47 (Euro 5.74/\$7.22 - Euro 5.99/\$7.50)” for three- to six-kilogram salmon (converts to £3.92/kg - £4.07/kg).<sup>3</sup>

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<sup>2</sup> *IntraFish*. 19 May 2006. EU salmon prices hit 13-year high”. Available at: <http://www.intrafish.no/global/news/article106392.ece>

<sup>3</sup> *IntraFish*. 19 June 2006. Norwegian salmon prices keep climbing. Available at: <http://www.intrafish.no/global/news/article108104.ece>

At the beginning of the year, before the Pan Fish-Marine Harvest merger, <sup>Original Source: IntraFish</sup> a little more than 2 £/kg, below the peak set for this time of the year in 2000. The Atlantic salmon price graph below clearly demonstrates salmon price beginning to rise around the 9th week of 2006 (early March) and continuing to increase to date.

If one reviews the timeline of concentrations in the salmon farming industry and increased ownership by Mr. John Fredriksen, a pattern becomes apparent. Namely, as control increases and as the farmed salmon sector becomes more consolidated, prices increase accordingly. The industry has been consolidating for several years. Until Mr. Fredriksen, the most notable was the Marine Harvest joint venture of Stolt and Nutreco, then two of the six largest producers.

The consolidation of the farmed salmon industry intensified when Norwegian citizen and billionaire John Fredriksen purchased 48% of Pan Fish shares on 7 June 2005. Shortly after, Mr. Fredriksen purchased 25% of Fjord Seafood shares. And a couple months later, Pan Fish (via Fredriksen) completed its takeover of Aqua Farms, which increased Pan Fish's production capacity by 33%. While prices in 2005 do not come close to 2006 prices, one does observe that salmon prices in the later half of 2005 do not follow the same sharp decline that occurred with prices in 2000 through 2004.

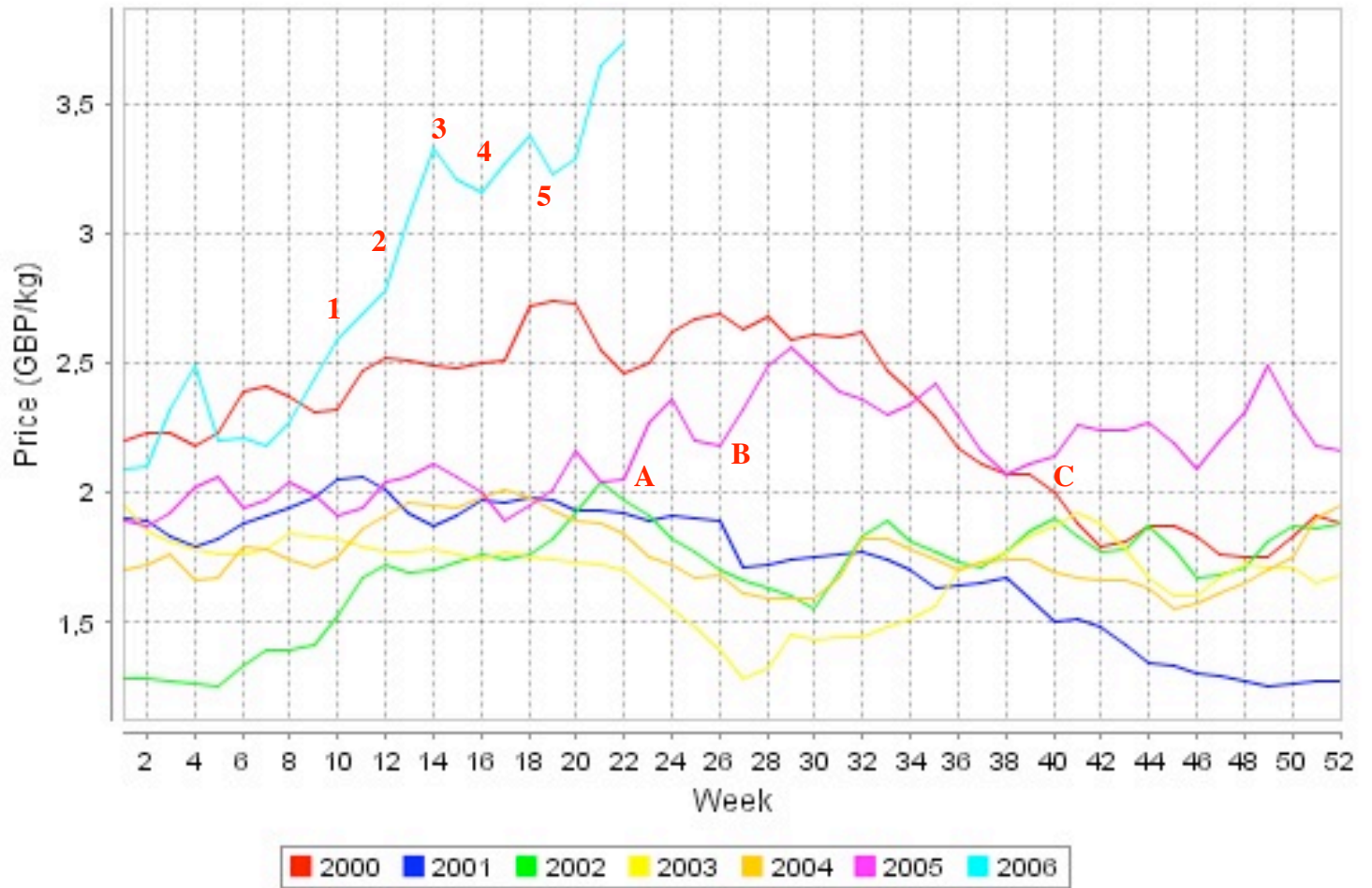
The concentration efforts by Mr. Fredriksen and Pan Fish continued on 7 March 2006, when Fredriksen's Gevean Trading agreed to purchase 100% of Dutch-based Marine Harvest, from Nutreco Holding and Stolt Sea Farms. Together, Pan Fish claimed that this salmon farming entity would account for 20% of global farmed salmon market share (In a previous memo, we point out that Marine Harvest alone had claimed a higher market share.) Then, one month later, Pan Fish purchased additional shares in Fjord Seafood bringing its stake in Fjord to 57.7%. And, as a result of having a majority stake in Fjord, Pan Fish announced in late April 2006 that it would meet mandatory requirements to put in an offer for the remaining outstanding shares in Fjord Seafood. This bid was approved by the Oslo Stock Exchange on 10 May 2006.

The graph below illustrates the temporal connection between salmon prices increases and each step of consolidation by Pan Fish and Mr. Fredriksen. While 2006 salmon price began at just about 2£/kg (lower than 2000 price), immediately after announcement of the merger, price began to rise, and has now risen to close to 4£/kg.

# Fresh Atlantic salmon cross-section

FCA Oslo

Source: IntraFish



#### **GRAPH TIMELINE/LEGEND:**

- A. 7 June 2005 (Week 23) - Norwegian billionaire John Fredriksen makes first purchase of Pan Fish (48% of shares).
- B. 27 June 2006 (Week 27) - Fredriksen makes first purchase of Fjord Seafood (25% of shares).
- C. 10 October 2005 (Week 41)- Pan Fish (via Fredriksen) completes takeover of Aqua Farms (increases production capacity by 33 percent).
- 1. 6 March 2006 (Week 10) - On 6 March 2006, Geveran Trading enters into a share purchase agreement with the owners of Marine Harvest (Nutreco Holding NV and Stolt Sea Farming Investments B.V.) for the purchase of 100% of the shares in Marine Harvest.
- 2. 24 March 2006 (Week 12) - Pan Fish shareholders approve purchase of Marine Harvest. PF-MH combined account for about 20 % of world salmon production.
- 3. 7 April 2006 (Week 14) - Pan Fish purchases 17.7 % in Fjord Seafood, bringing it to 57.7%.
- 4. 26 April 2006 (Week 16) - Pan Fish announces it will meet mandatory requirements to put in an offer for the remaining outstanding shares in Fjord Seafood within four weeks deadline.
- 5. 10 May 2006 (Week 19) - Oslo Stock Exchange approves Pan Fish's bid to purchase 100% of Fjord Seafood shares.

While prices commonly rise during the first half of the year, this rise is far swifter than in years past. In fact, industry experts have commented that prices are unlikely to drop in the 12 to 18 months. *IntraFish* has reported that “in the United Kingdom, some processors say they don’t expect any significant drop in prices before the end of 2007.”<sup>4</sup>

And, in a 26 May 2006 article, UK’s Scot Trout Managing Director, Muir Hunter, explains that he does not see salmon prices falling for the next 18 months, stating: “ I don’t see much of a reduction until 2008, we are pretty much short of fish unless demand comes off.”<sup>5</sup> (Such comment may be self-serving sales banter.)

As a practical matter, a large retailer may prefer to source from fewer producers who can guarantee quality and meet specifications than from numerous producers. Beyond the top two or three producers, there are essentially none that could supply all of the needs of major retailers such as Tesco, Carrefour or Ahold. Consequently, the question is whether Pan Fish is now expecting higher prices for its product from these large buyers (which smaller producers may be more than happy to follow).

One explanation for rising prices that we believe cannot be ignored is that this consolidation confers control over pricing.

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<sup>4</sup> *IntraFish*. 14 June 2006. French salmon prices continue at Euro 6. Available at: <http://www.intrafish.no/global/news/article107755.ece>

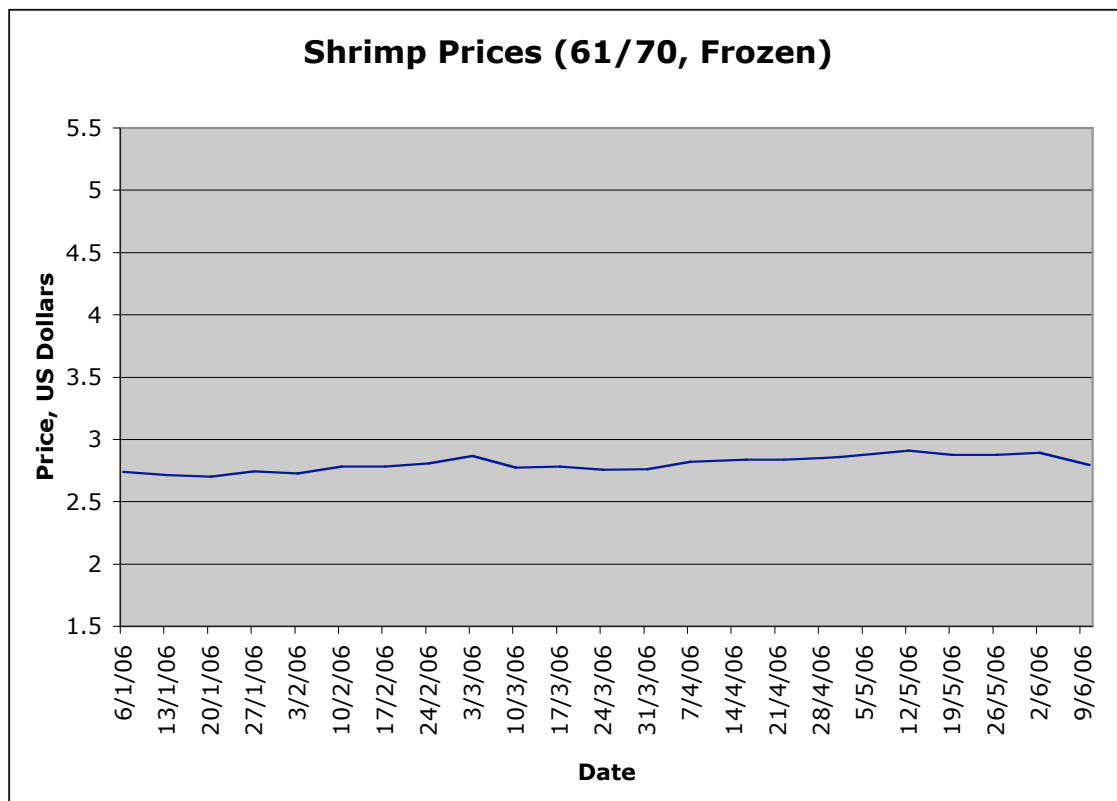
<sup>5</sup> *IntraFish*. 26 May 2006 Scot Trout sees no end in sight to high salmon prices.

## Shrimp Prices

One explanation may be that seafood and fish is generally more attractive to consumers. One press account profiling the rise of Pan Fish notes that bird flu is driving renewed seafood demand.<sup>6</sup>

But the rising price of farmed salmon is not matched by other fish commodities, such as shrimp. Another widely consumed global seafood market comprised of both wild and farmed varieties, the shrimp market is largely unconsolidated - with literally thousands of small-scale producers operating in different regions. Prices for frozen shrimp (61/70 grade) for 2006 (in US dollars) clearly do not resemble the trend of farmed salmon prices in the same period. In fact, while shrimp prices were similar to salmon prices at the beginning of the year, they have remained largely stable to date.

We note that on 8 June 2006, it was reported “for the first time ever, the value of Norway's exports of farmed seafood surpassed the export of wild-caught fish in the first five months of 2006, pushed by high salmon prices.”<sup>7</sup> That is, fish generally doesn't seem to command the rising price that farmed salmon is fetching.



**Source:** Weekly price information was obtained from Market Data from Foodservice.com (www.foodservice.com) - An Online Community for Foodservice Operators.

<sup>6</sup> Reuters. 23 June 2006. Investors welcome salmon farm king, ecologists worry.

<sup>7</sup> IntraFish. 8 June 2006. High salmon prices push Norway's aquaculture exports to record levels. Available at: <http://www.intrafish.no/global/news/article107438.ece>

On the one hand, shrimp lacks some of the health benefits such as Omega 3 fatty acids, and therefore demand may be driven by different factors. On the other hand, shrimp and salmon have been common best sellers in the fresh seafood section of major retailers, suggesting shoppers commonly seek one or both items when filling out a menu.

### ***Is Consumer Demand Intensifying?***

As prices have risen, there have been numerous media accounts relaying fears that increasing farmed salmon prices will cause consumers in the UK and abroad to turn away from farmed salmon. While high wholesale salmon prices seem not to have dissuaded salmon consumers to date, Scot Trout Managing Director, Muir Hunter, has explained that he “fears for the consequences when they eventually do filter through to the checkout tills.”<sup>8</sup> In May 2006, France’s major salmon importer, Direct Ocean Fresh Category manager, Sylvie Feutry, made a concurring statement in *IntraFish* in late May 2006. Feutry explained “if producers continue to push fish onto the market at such high prices, consumers will lose interest and prices will consequently fall.” Since May, prices have continued to rise.<sup>9</sup>

It appears that European processors have been bearing most of the burden of rising prices. In May 2006, *IntraFish* reported: “French processors are finding it increasingly difficult to pass on price increases to the supermarket sector, according to Bretagne Salmon General Manager Herve Delpierre. The problem is magnified when supermarkets grudgingly accept price increases by a time lag, which leaves processors waiting up to three months to receive increased payments.”

According to this article, “French seafood processors are not been the only victims of an ongoing price war, as supermarkets have sought to boost their market share against a background of sluggish economic growth.”<sup>10</sup>

### ***Barriers to Entry***

An efficient economic response to rising prices is new entries. Under current operating practices, geographies limit open net pen farmed salmon. In Norway, Scotland and Canada, limits on licensing frustrate new entries. This is a controversial industry in these nations and no new license has been awarded for a number of years.

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<sup>8</sup> *IntraFish* 26 May 2006. Scot Trout sees no end in sight to high salmon prices. Available at: <http://www.intrafish.no/global/news/article106743.ece>

<sup>9</sup> *IntraFish*. 24 May 2006. Direct Ocean: 6 euro salmon price too high. Available at: <http://www.intrafish.no/global/news/article106563.ece>

<sup>10</sup> *IntraFish*. 11 May 2006. French processors swallow salmon price rises. Available at: <http://www.intrafish.no/global/news/article105844.ece>

In fact, in Norway, the world's leading producers, a government-sponsored committee is at work deciding which additional fjords to seal off permanently from future salmon farming. There is a similar committee at work on restricting new salmon farming in western Canada where the British Columbia Special Committee on Sustainable Aquaculture is engaging in a series of hearings.<sup>11</sup> In Scotland, the new Pan Fish, which controls at least 50% of production, has announced it will reduce operations. In the last year, Chile has actually produced less salmon than in the previous year, as noted before. Industry concentration in Chile has also intensified, and is now more concentrated than Norway.

### ***Stagnating or Decreasing Supply***

As Pan Fish concluded in a March 2006 prospectus, “As a consequence of the limited supply ... the prices for both fresh salmon fillets and whole fresh salmon have increased to a historic high level.”<sup>12</sup> While “limited supply” in this context likely refers to constraints of production cycles, could it also be possible that producers have actually reduced the volume of salmon entering the market?

We know that Norwegian fresh Atlantic salmon exports to the United Kingdom are rising, with imported fresh salmon to the UK at 1,042 metric tons compared to 525 metric tons the year prior.<sup>13</sup> In addition, Norway increased its exports of fresh farmed Atlantic salmon fillets to the US 363 percent in the first four months of 2006 up to 1.1 million kilograms.<sup>14</sup> These are relatively small sources for the UK. Scottish production has declined.

In this same period, total imports of fresh Atlantic salmon fillets declined by 19.8 percent in the United States from January to April “while the value of those imports climbed 14 percent.” Total US salmon imports (including canned products) in this period remained relatively flat, with a total gain of 0.02%.<sup>15</sup>

Also, SalmonChile reported that in Chile, while “total salmon and trout exports generated a total USD 690.3 million (FOB Chile) between January and April 2006...the volume exported during the four first months was of 138,875 net tonnes of salmon and trout, which represented a 3% cent fall compared with the same period last year.”<sup>16</sup> In this

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<sup>11</sup> <http://www.legis.gov.bc.ca/cmt/38thparl/session-2/aquaculture/index.htm>

<sup>12</sup> Pan Fish Prospectus. 23 March 2006. Page 59. Available at: <http://panfish.com/newsread/ReadImage.asp?WCI=GetByID&IMAGEID=6&DOCID=10180>

<sup>13</sup> *IntraFish*. 12 June 2006. Norwegian salmon exports to U.K. boom. Available at: <http://www.intrafish.no/global/news/article107665.ece>

<sup>14</sup> *IntraFish*. 14 June 2006. Norway makes gains in U.S. salmon market. Available at: <http://www.intrafish.no/global/news/article107813.ece>

<sup>15</sup> *IntraFish*. 14 June 2006. Norway makes gains in U.S. salmon market. Available at: <http://www.intrafish.no/global/news/article107813.ece>

<sup>16</sup> *Fish Information and Services*. 19 June 2006. Salmonid exports generate USD 690.3 million during the first quarter.

period, exports of fresh Atlantic salmon from Chile to its major US market decreased by 21.3% to 24.1 million kilos, representing a drop of about 6.5 million kilos.<sup>17</sup>

The most pressing question for competition authorities is: what are producers deciding now? Are they increasing production in response to apparently increased demand (and certainly increasing prices)?

Given the proprietary nature of this information, we urge the Office of Fair Trading to ask Pan Fish (also Marine Harvest and Fjord Seafood):

- How many smolts they put into production two years ago? One year ago? Six months ago? Most recently?
- What is their projected production volume for 2006, 2007 and 2008?
- Have they delayed harvesting and/or selling adult salmon?

We believe that competition authorities cannot ignore the possible connection between rising prices and reduced competition. Nor do we think authorities can rely on new producers to mitigate price rises. Britain's key sources for farmed salmon have high entry barriers, and the one geography that might have a lower entry barriers – Chile – is an ocean away. What authorities can do is rigorously eliminate the possibility that the proposed Pan Fish combination is part of this price rise.

Sincerely,

Andrea Kavanagh  
Director  
The Pure Salmon Campaign

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<sup>17</sup> *IntraFish*. 14 June 2006. Norway makes gains in U.S. salmon market. Available at: <http://www.intrafish.no/global/news/article107813.ece>