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Statement of Preliminary Issues

Fletcher Distribution/the Tumu companies

5 April 2022

Introduction

1. On 19 March 2022, the Commerce Commission registered an application (the Application) from Fletcher Distribution Limited (FDL) seeking clearance to acquire six ITM stores and a frame and truss manufacturing plant from Tumu Merchants Limited (Tumu) (the Proposed Acquisition). The relevant ITM stores are located in Gisborne, Napier, Hastings, Havelock North, Dannevirke and Masterton and the frame and truss plant is in Hastings.[1]

2. As a result of the Proposed Acquisition, FDL or an interconnected body corporate of FDL would acquire up to 100% of the shares in, or assets of, the following legal entities from Tumu:

   2.1 Tumu Gisborne Limited;

   2.2 Tumu Napier Limited;

   2.3 Tumu Hastings Limited;

   2.4 Tumu Havelock North Limited;

   2.5 Tumu Dannevirke Limited;

   2.6 Tumu Masterton Limited; and

   2.7 Tumu Frame & Truss Limited

   (the Tumu companies).

3. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

4. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

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1 A public version of the Application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

2 The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

5. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **22 April 2022**.

6. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The parties

7. FDL and the Tumu companies both supply building products and related goods and services to trade and retail customers.

FDL

8. FDL is a wholly owned subsidiary of Fletcher Building Limited. Fletcher Building Limited is a diversified building products company involved in the manufacture and distribution of building products, residential development and commercial construction. FDL owns and operates the national network of 62 PlaceMakers stores that sell building products and related goods and services, and also has eight frame and truss manufacturing plants located throughout New Zealand.

9. Most relevant to the Application, PlaceMakers has four stores in:

   9.1 Hawke's Bay (Napier and Hastings);

   9.2 Wairarapa (Masterton); and

   9.3 Manawatū-Whanganui (Palmerston North),

   and a frame and truss plant in Taupō, from which it supplies the Hawke's Bay.

Tumu

10. The vendor, Tumu, forms part of the Tumu Group, a privately-owned group of companies. In addition to the companies that are the subject of the Proposed Acquisition, it has investments in wood remanufacturing and processing, sawmilling, importing and wholesaling of building materials, property investment and financing, and land and property development.

11. Relevant to the Application, the Tumu companies distribute and sell building products and related goods and services from six ITM-branded store locations in the North Island. These stores are in:

    11.1 Hawke's Bay (Napier, Hastings and Havelock North);

    11.2 Wairarapa (Masterton);

    11.3 Manawatū-Whanganui (Dannevirke); and

11.4 Bay of Plenty (Gisborne),

and its frame and truss manufacturing plant is located in Hawke's Bay (Hastings).

Our framework

12. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[3] As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

13. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[4] This allows us to assess the degree by which the Proposed Acquisition might lessen competition.

14. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:

    14.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;

    14.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    14.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Market definition

15. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[5]

16. In the Application, FDL submitted that the relevant markets are:[6]

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[3] Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz.

[4] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

[5] Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

[6] The Application at [29].

16.1 regional markets for the retail supply of building products and related goods and services in the Hawke's Bay, Wairarapa and Manawatu-Whanganui; and

16.2 a North Island market for the manufacture and supply of frame and truss.

17. FDL submitted that trade and retail/DIY customers are supplied in the same market.[7] It submitted that:[8]

17.1 the same building products are generally suitable for both DIY and trade customers; and

17.2 competitors stock products suitable for DIY and trade customers, and can readily adjust their product ranges in response to changes in consumer demand.

18. FDL further submitted that merchants such as FDL and ITM (as well as Mitre 10, Carters and Bunnings) sell building products in the same markets as category specialists (eg paint and decorating), direct suppliers (eg roofing materials manufacturers) and online building product retailers (eg, Trade Depot).[9]

19. On geographic market definition, FDL submitted that the precise geographic scope of the markets are unlikely to be determinative given the presence of competitors in even the narrowest of geographic markets. Nevertheless, it submitted that:[10]

19.1 it is appropriate to define regional markets for the supply of building products and related goods because:

19.1.1 most of the sales of FDL and the Tumu companies are delivered to customers, rather than customers purchasing and picking up products at a specific store; and

19.1.2 merchants, category specialists, online retailers and direct suppliers tend to supply customers on at least a regional basis;

19.2 the Hawke's Bay regional building products market includes Napier, Hastings and Havelock North and regional Hawke's Bay, but excludes Wairoa given its distance from Napier/Hastings;[11]

19.3 the Wairarapa regional building products market includes Masterton (where the merging parties both have stores), plus Carterton, Greytown, Featherston and Martinborough;[12]

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7 The Application at [33.2].

8 The Application at [48].

9 The Application at [36]-[37].

10 The Application at [50]-[61], [64]-[65], [66.1], [72] and footnote 6.

11 This is based on the locations to which PlaceMakers in Napier delivered building products in FY21. See the Application at [56]-[57].

12 This is based on the locations to which PlaceMakers in Masterton delivered building products in FY21. See the Application at [54]-[55].

19.4 the Manawatū-Whanganui regional building products market includes Palmerston North (where FDL has a store) and Dannevirke (where there is a Tumu ITM store);[13]

19.5 it has not defined a Gisborne or East Coast regional building products market because FDL does not have a store in Gisborne and it only supplies a small amount of product into Gisborne; and

19.6 a national market is appropriate for frame and truss because it is transported to customers over long distances, with FDL currently supplying frame and truss into the Hawke's Bay (where Tumu has a frame and truss plant) from Taupō.

20. We will consider whether these are the appropriate markets for considering the competition effects of the Proposed Acquisition, or whether:

20.1 it is appropriate to define separate markets for retail and DIY customers;

20.2 large merchants such as FDL and ITM (as well as Mitre 10, Carters and Bunnings) sell building products in the same markets, or separate markets, to category specialists, direct suppliers and online building product retailers; and/or

20.3 it is appropriate to define narrower geographic markets for the:

20.3.1 retail supply of building products; and/or

20.3.2 frame and truss.

Without the acquisition

21. In the Application, FDL submitted that the counterfactual is the status quo.[14]

22. We will consider what the parties would do if the Proposed Acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options (eg, finding a different buyer for the Tumu companies).

Preliminary issues

23. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral, coordinated and/or vertical/conglomerate effects might result from the Proposed Acquisition. The questions that we will be focusing on are:

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13 This is based on the locations to which PlaceMakers in Palmerston North delivered building products in FY21. See the Application at [58].

14 The Application at [26].

23.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?[15]

23.2 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

23.3 vertical or conglomerate effects: would the Proposed Acquisition increase the merged entity's ability and/or incentive to foreclose rivals?

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

24. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase prices above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.

25. FDL and the Tumu companies compete to supply building products and related goods and services to trade and retail customers.

26. In the Application, FDL submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any relevant markets due to unilateral effects because:[16]

26.1 in the supply of building products:

26.1.1 the Proposed Acquisition would lead to modest market share aggregation, and FDL and the Tumu companies are not each other's closest competitor;

26.1.2 there are other competitors in each relevant region, including other merchants (including ITM stores) and category specialists;

26.1.3 strong price competition between merchants would remain post-acquisition;

26.1.4 new entry and expansion by merchants (including ITM) is likely; and

26.1.5 category specialists and direct suppliers account for over half of building product sales; and

[15] For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

[16] The Application at [68], [88], [113] and [117].

26.2 in the supply of frame and truss:

26.2.1 there would be a low aggregation in market share; and

26.2.2 several competitors would remain.

27. We will consider:

27.1 *closeness of competition*: the degree of constraint that FDL and the Tumu companies impose upon one another, including taking into account geographic proximity and product range. To the extent that any constraint is material, we will assess whether the lost competition between the merging parties is likely to be replaced by rival competitors;

27.2 *remaining competitive constraints*: the degree of constraint that existing competitors would impose on the merged entity. In the case of the supply of building products, we will consider the constraint from rival merchants (Mitre 10, Carters, Bunnings and ITM), including the size, location, customer mix and product range of each of these merchants, and other suppliers (category specialists, direct suppliers and online building product retailers);

27.3 *entry and expansion*: how easily rivals could enter and/or expand, including the ability to secure sites suitable for entry/expansion; and

27.4 *countervailing power*: whether certain customers have special characteristics that would enable them to resist a price increase by the merged entity.[17]

Coordinated effects: would the Proposed Acquisition make coordination more likely?

28. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[18]

29. In the Application, FDL submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the relevant markets due to coordinated effects due to the numerous competitors that would remain, as well as because:[19]

29.1 it would be impossible to reach any form of tacit coordination with competitors where quoted pricing is specific to particular jobs; and

[17] Countervailing power is more than a customer's ability to switch from buying products from the merged entity to buying products from a competitor. A customer may have countervailing power if it is able to switch to self-supply (eg, by importing) or if it is able to sponsor new entry. *Mergers and Acquisitions Guidelines* above n3 at [3.115].

[18] *Mergers and Acquisitions Guidelines* above n3 at [3.84].

[19] The Application at [127].

29.2 in respect of shelf prices, the thousands of SKUs stocked in each store would make it impossible for competitors to reach and enforce a tacit understanding about prices for these products.

30. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Vertical or conglomerate effects: would the merged entity be able to foreclose rivals?

31. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.

32. In the Application, FDL submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the relevant markets due to vertical or conglomerate effects because:[20]

32.1 the Proposed Acquisition does not result in any material change in vertical integration; and

32.2 given the broadly similar product range supplied by each of the parties, conglomerate effects are not relevant.

33. We will check that the Proposed Acquisition would not give FDL a greater ability or incentive to foreclose competitors in a relevant market. This will include considering whether:

33.1 the Proposed Acquisition would give the merged entity the ability to restrict competitors access to inputs or customers; and/or

33.2 the merged entity would have any 'must have' products that it could bundle or tie in a way that hindered the ability of competitors to compete.

Next steps in our investigation

34. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **19 May 2022**. However, this date may change as our investigation progresses.[21] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

35. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

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[20] The Application at [128]-[129].

[21] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.

Making a submission

36. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "FDL/ITM" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **22 April 2022**.

37. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

38. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.