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By email

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MATTER NO. 400-4888
PARTNER Haydn Wong
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Dear Mya

Restrictive Trade Practice Allegations - Godfrey Hirst

In response to the issues raised by Godfrey Hirst through its legal advisers, our client's view is that the underlying substance of all the issues raised are matters which directly or indirectly were raised by Godfrey Hirst in respect of the previous application and dismissed by the Commission (in Decision 725) and by the High Court. Accordingly, our client's view is that the current allegations are advanced as either an attempt to confuse the issues to be considered under the current Application or to delay the investigation, or both. Any competition effects associated with the transaction are brought about by the business acquisition for which authorisation is sought, not by any ancillary provisions of the commercial documentation. We expand below on the reasons for this position. However, this response is an initial reaction to the allegations and a more detailed response will be provided once Godfrey Hirst provides a more coherent submission. At the current time, Cavalier Wool Holdings' (**CWH**) initial reaction is that none of the allegations provide a prima facie case for breach of any provision of Part II of the Commerce Act.

Site Covenants

First, in the documentation and decisions resulting in Decision 725, it was clear that the properties at Whakatu and Kaputone would be sold with non-scouring covenants (see conference transcript 5 May 2011 at page 22, and NZWSI post-conference submission at paragraph 10). Nowhere in that decision or in the following High Court Judgment is there a finding that such covenanting actions would give rise to any competition effects beyond the competition effects arising from the basic acquisition. Further, none of the relevant site restrictions could be said to substantially lessen competition in any market (nor could they be said to fix prices or otherwise constitute a restrictive trade practice under Part II). In Decision 725 the Commission found that new domestic entry would in part constrain the acquirer and found that there was available land for that new entry to occur, notwithstanding the restrictions on future use of the Whakatu and Kaputone land and buildings.

Secondly, provisions of the agreements that require closure of sites and non-scouring covenants to be placed on those sites are solely for the purpose of protecting the purchasers in respect of the goodwill of the business being acquired. Accordingly, such restrictions are exempt under section 44(1)(d), from Part II of the Act.

Vertical Effects

In light of the findings in Decision 725 and the High Court, that the shareholders in the merged entity have interests in operations at other levels of the broader wool related markets is of no relevance to the current investigation. Any possible vertical effects arise solely from the acquisition of the business, not from any ancillary contractual arrangements between the parties.

Furthermore, the Commission in Decision 725 found that the acquisition at that time would not have, or be likely to have the effect of substantially lessening competition in any market other than the wool scouring market. If anything, the diluted shareholding in this case of Cavalier Bremworth compared to the transaction considered in Decision 725 would provide less ability/incentive for the merged entity to foreclose or raise costs of Godfrey Hirst. This allegation was traversed at length by Godfrey Hirst and its advisers during the previous application and in the High Court and dismissed (see Decision 725 at [195]-[210] and the High Court judgment at [236]-[242]). There is nothing fresh in the current application giving rise to a different outcome.

At the time of the earlier decision, Cavalier Bremworth had a 50% shareholding and one director on a Board of three (one director for each shareholder). In respect of the current proposal Cavalier Bremworth has its shareholding diluted to 27.5% and still has only one director of an intended enlarged Board of five - together a much reduced level of influence. The incentives of the shareholders must be to maintain maximum revenues for the company for the benefit of the shareholders as a whole and not to reduce the available revenues for the benefit of a 27.5% shareholder and as a detriment to the remaining 72.5% shareholders. Further, factually, there has been no evidence or proven allegations of discrimination in favour of Cavalier Bremworth during the period since Godfrey Hirst sold its scouring business to interests associated with CWH.

General Comment

Even if there was thought to be a potential restrictive trade practice in breach of Part II of the Act (which for the reasons above the applicant denies) those matters are quite separate from the Commission's consideration of the application for authorisation of a business acquisition under section 67 of the Act. Such restrictive trade practices would only arise in the event that the Commission grants authorisation under section 67, but it is not a matter that the Commission is required to address or should address as part of its section 67 investigation.

Once the Commission finds a substantial lessening of competition arising from the acquisition, as it did in Decision 725 and will no doubt find in respect of this application, the issue remaining is solely to determine the extent of the detriments and benefits arising from the transaction. Any ancillary provisions of the agreement are relevant only to assessing the detriments and whether they are somehow increased by any such provision. The same factual base (the nonscouring covenants on sale in respect of Whakatu and Kaputone and the existence of Cavalier Bremworth as a shareholder and with a director) was in existence in respect of Decision 725 but was not found to give rise to an increase in the quantification of detriments. Nothing changes in respect of that quantification because the same matters now derive from a multi party agreement. There is no substantial lessening of competition.

CWH would wish to make further submissions when Godfrey Hirst clarifies its allegations.

Kind regards

[Sgd: Phil Taylor / Glenn Shewan]

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Consultant / Senior Associate