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Statement of Preliminary Issues

Gebr. Knauf KG / USG Corporation

9 January 2019

Introduction

1. On 20 December 2018, the Commerce Commission registered an application (the Application) from Gebr. Knauf KG (Knauf) and USG Corporation (USG) (together, the Parties) seeking clearance to merge (the proposed merger).[1]

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

3. This Statement of Preliminary Issues sets out the competition issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties who wish to make a submission do so by **1 February 2019**.

The Parties

5. Knauf is a multinational company based in Germany that operates globally in the building materials supply industry. It manufactures and supplies a range of products including plasterboard, cement board, metal profiles, plasters and suspended ceiling components. In New Zealand, Knauf is active in the importation and supply of tiles and grids used for modular suspended ceilings, and insulation products.

6. USG is a global manufacturer and supplier of building materials headquartered in the USA and manufactures a similar range of products. USG is active in New Zealand through its 50%-owned joint venture with Boral Limited, USG Boral Building Products NZ (USG Boral), which supplies suspended ceiling components and other building materials through third party distributors.

7. USG Boral in turn owns 50% of Rondo Building Services Pty Ltd (Rondo), with the other 50% owned by CSR Limited. Rondo manufactures and supplies various metal building products in New Zealand (and Australia), including steel ceiling grids.

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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.

8. The Parties submitted that they compete in New Zealand only in the supply of modular suspended ceilings.[3] These are ceilings comprising a grid (ie, a suspension system) that is affixed to a building's structure and tiles that are laid into the grid. The tiles are not fixed to the grid, meaning they can be moved to provide access to the technical equipment concealed by the ceiling (such as ventilation).

9. Separately from its proposed merger with USG, Knauf has entered into an agreement to acquire the EMEA and APAC[4] businesses of Armstrong World Industries, Inc (AWI), a global manufacturer and supplier of building products including modular suspended ceilings.[5] As AWI imports and supplies ceiling tiles and grids into New Zealand, the AWI transaction would result in overlap in the supply of modular suspended ceiling components in New Zealand. We will consider the impact of the AWI transaction in our competition analysis.

Our framework

10. Our approach to analysing the competition effects of the proposed merger is based on the principles set out in our Mergers and Acquisitions Guidelines.[6] As required by the Commerce Act 1986 (the Act), we assess mergers and acquisitions using the substantial lessening of competition test.

11. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[7] This allows us to assess the degree by which the proposed merger might lessen competition.

12. If the lessening of competition resulting from the proposed merger is likely to be substantial, we will not give clearance. When making that assessment we consider, among other matters:

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

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

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

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3 The Application at [34].

4 Europe, Middle East and Asia (EMEA), and Asia-Pacific (APAC).

5 The Application at [12].

6 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz/business/merging-or-acquiring-a-company.

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

Market definition

13. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed merger. 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 Act, as a matter of fact and commercial common sense.[8]

14. The Parties submitted that the relevant market is the national market for the wholesale supply of modular suspended ceilings.[9]

15. We will assess whether the market proposed by the Parties is appropriate, including whether the market(s) should be defined more widely or more narrowly. In doing so, the issues we examine will include:

    15.1 whether grids and tiles for modular suspended ceilings fall within the same market (as submitted by the Parties) or whether these two product categories constitute separate markets;

    15.2 whether different types of grids and tiles for modular suspended ceilings are sufficiently substitutable to customers, such that they should be considered as being within the same market; and

    15.3 the extent to which various types of grids and tiles are compatible (ie, can be used together in a modular suspended ceiling).

Without the proposed merger

16. The Parties submitted that, without the proposed merger, the status quo would prevail, in which Knauf and USG would continue their respective business activities in competition with each other.[10] We will consider what would be likely to happen should the proposed merger not proceed.

Preliminary issues

17. We will investigate whether the proposed merger would be likely to substantially lessen competition in the relevant market(s) by assessing whether horizontal unilateral or coordinated effects might result from the merger. The questions on which we will be focusing are:

    17.1 *unilateral effects*: would the loss of competition between the Parties enable the merged entity to profitably raise prices or to reduce the quality of the products it supplies (for example, by reducing its investment in research and development);[11] and

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

9 The Application at [45].

10 The Application at [53].

11 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 its rate

17.2 *coordinated effects*: would the proposed merger change the conditions in the relevant market(s) so that coordination between market participants is more likely, more complete, or more sustainable?

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

18. 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 price above the level that would prevail without the merger. A merger could also reduce competition if one of the merging firms is a potential or emerging competitor, which may provide stronger competition in the future.

19. The Parties submitted that there are a number of factors which mean that the proposed merger will not substantially lessen competition, namely that:[12]

19.1 imports by third parties will constrain the merged entity;

19.2 the market is characterised by low barriers to entry;

19.3 customers exercise significant countervailing power through the expertise and industry knowledge of architects, specifiers and installers;

19.4 there are a number of alternative suppliers available to customers; and

19.5 manufacturers of metal products could easily commence production of ceiling grid in response to a price increase by the merged entity.

20. In assessing whether the proposed merger would be likely to give rise to unilateral effects, the factors we consider will include the following.

20.1 Closeness of competition: the degree of constraint that Knauf (including AWI) and USG currently impose upon one another. To the extent that any constraint is material, we will assess whether the loss of competition between the merging parties would be replaced by rival competitors. We will also assess the extent to which Knauf and USG may compete with each other in the future absent the proposed merger (for example by introducing new products).

20.2 Remaining competitive constraints: the degree of constraint that existing competitors would impose on the merged entity.

20.3 Entry and expansion: whether competitors are likely to enter or expand on a sufficient scale and within a reasonable time period, such that they would constrain the merged entity.

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of innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

12 The Application at [75]-[103].

20.4 Countervailing power: we will examine the ability of New Zealand distributors to sponsor new entry or to seek their own supply through the importation of components for modular suspended ceilings from independent third party suppliers, and whether those strategies are likely to provide sufficient competitive constraint post-merger.

Coordinated effects: would the proposed merger make coordination more likely?

21. A merger can substantially lessen competition if it increases the potential for the merged firm and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that prices increase across the market.

22. We will assess whether any relevant market is vulnerable to coordination and whether the proposed merger would change conditions in any market so that coordination is more likely, more complete, or more sustainable.

Next steps in our investigation

23. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed merger by **11 March 2019**. However, this date may change as our investigation progresses.[13] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

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

Making a submission

25. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Knauf/USG" 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 **1 February 2019**.

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

27. 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.

[13] The Commission maintains a case register on our website at https://comcom.govt.nz/case-register where we update any changes to our deadlines and provide relevant documents.