1 September 2022

Residential building supplies market study: Fletcher Building's submission on the New Zealand Commerce Commission's draft report

1. Summary

1.1 This submission outlines Fletcher Building's response to the Commission's Draft Report.

1.2 We address the following in further detail in this response, but in summary:

(a) as noted in our response on regulatory issues, we do not believe the New Zealand regulatory system is 'broken' by any means. However, we recognise that improvements can always be made, and we support the direction and intent of the Commission's draft recommendations, while offering some observations to ensure that any changes do not create unintended adverse consequences for New Zealand;

(b) as the Commission notes, retroactive rebates are widespread. We acknowledge that, as a matter of theory, *in some circumstances*, some rebates can create a competition issue. But generally speaking, we see these circumstances as unlikely in the case of straight volume rebates. We do not believe the rebates used by our businesses are likely to transgress the new section 36 or, in the case of Winstone Wallboards, that they have driven GIB®'s high market share. Winstone Wallboards' arrangements with merchants were reviewed in detail by the Commission in 2014, with the Commission concluding they neither amounted to a misuse of market power nor a substantial lessening of competition (being the revised section 36 standard), but rather there were other factors accounting for GIB®'s high share. Nothing has changed, and GIB®'s competitive position and success is the result of Winstone Wallboards' provision of a great product which it supplements with excellent technical and other customer support;

(c) if the Commission is minded to interpret the new section 36 (which applies the same competition standard as the long-standing section 27) as applying to retroactive rebates in some cases, we believe it has the responsibility to the whole economy (and not just the building products industry) to explain how it came to that conclusion and where it believes the line is between pro and anti-competitive conduct. Firms like us are keen to comply with the law, so the Commission's input will be valued, but it must be clear and available to enable firms to respond in a timely fashion; and

(d) in our view, the use of customer specific quotes (**CSQs**) is not a cause for any concern – they reflect competition in action. Indeed, it would be a perverse outcome if firms, however large, were constrained in their ability to compete for customers by offering lower prices (save of course where that amounted to predatory pricing). Further, if the Commission's intent is to discourage conduct by some firms and not others when that conduct is not a breach of the Commerce Act, we disagree. Sound competition policy is, and must remain, focused on protecting the competitive *process* rather than the fate of individual *competitors*.

2. Draft recommendations to enhance the regulatory system

2.1 We continue to support a regulatory system that is as efficient and effective as it can be for a country of New Zealand's size and demography. We also support a regulatory system that takes appropriate account of a Te Ao Māori perspective.[1]

2.2 We focus in this section on the Commission's recommendations to improve the regulatory system.

2.3 As noted, we do not believe the regulatory system is 'broken'. However, we recognise that improvements can be made and, generally speaking, we support the direction and intent of the associated draft recommendations. We do so notwithstanding our view that the focus of the market study has been on Winstone Wallboards and the recommendations are directed at increasing the scope for firms to compete with Winstone Wallboards. We offer the following observations to ensure that any changes do not create unintended adverse consequences for New Zealand and New Zealanders.

Competition as a relevant consideration (but not a core objective) when amending the regulatory system.[2]

2.4 We agree that the core policy objective of the building regulatory system is to ensure homes and buildings are safe, healthy, and durable.[3] We also agree that there is (or can be) an inherent policy tension between this objective (and the regulations put in place to ensure this objective is achieved) and the objective of making it easy for participants to supply new products to promote competition.[4]

2.5 Our view is that ensuring homes and buildings are safe, healthy, and durable should remain the overriding objective in the building regulatory system. While we acknowledge that the Commission's intention is that including a competition objective would not undermine this core objective,[5] we are concerned that elevating it to a (seemingly) equal status risks having that effect in practice, and will potentially lead to worse outcomes for New Zealanders.

2.6 Rather than promoting competition being a standalone objective, we support making the impact on competition a *consideration* whenever MBIE is considering amendments to the regulatory system. Including competition as a consideration strikes the right balance and would ensure explicit consideration of any policy trade-offs between promotion of competition and the core objective of ensuring homes and buildings are safe, health, and durable.

Creating more compliance pathways.[6]

2.7 We support the recommendations for MBIE to update and develop more acceptable solutions and verification methods, and develop guidance for suppliers that identifies the appropriate Building Code clauses and the possible means of proving compliance with those clauses.[7]

2.8 We acknowledge there may be some value in the Commission's recommendation to enable international bodies to certify products as compliant with the NZ Building Code as well as against other Codes.[8] However, the implications of this will need to be carefully worked through. As we described above, the core objective of the building code is to ensure New Zealand homes and buildings are safe, healthy, and durable. New Zealand will not be better off if allowing multiple certification providers resulted in suppliers 'forum shopping' for a way to meet certification standards. A robust process would be needed to ensure

[1] Draft Recommendation 2.

[2] Draft Recommendation 1.

[3] Draft Report, para 3.12.

[4] Draft Report, para 3.153.

[5] Draft Report, para 9.29.

[6] Draft Recommendation 3.

[7] Draft Report, paras 9.40 and 9.46.

[8] Draft Report, paras 9.43-9.45.

that certification standards and results are consistent across certification bodies (wherever located), and that the requirements for suppliers to keep their product certifications current, and subject to periodic recertification / review, are well understood and enforced. Furthermore, to ensure the ultimate consumer (the homeowner) is protected, we believe such product certification should be supported by manufacturer guarantees.

Removing impediments to product substitution.[9]

2.9 We are supportive of the Commission's recommendation to give stronger direction about what constitutes a 'minor variation' to a building consent and we support MBIE providing guidance on product substitution.[10] However, any such changes should be clear, thoughtful, and practical, with the end-user and ease of compliance front of mind. We also agree with the Commission that going so far as to *prevent* specification of products or systems by brand would have drawbacks and reduce design choice[11] and we would not support such a change.

2.10 We prefer a regulatory solution that gives stronger and very clear direction about what constitutes a 'minor variation' to a building consent rather than mandating that specifiers include substitution options when plans and specifications are lodged.[12] Such a mandate could require a specifier to include at least two options for every product or system specified, or even alternative build solutions. This would be onerous for a specifier, confusing for builders and would mean additional time and cost in the consenting process more generally, substantially outweighing any theoretical benefit. Ultimately, this delay and cost would be borne by consumers. Conversely, stronger direction as to what constitutes a minor variation appears to us to be a much more targeted and proportionate intervention that would address the potential issue. See also our comments on the references in the Draft Report to 'tried and true' products in Section 5 below.

2.11 More generally, while we support removing unjustified impediments to substitution, care is needed to ensure that the implications of any changes are carefully worked through by MBIE to guard against any unintended negative impact on the safety, health, and durability of New Zealand's housing stock.

2.12 Specifically, it is important to recognise that substitution between *products* is different to substitution of products that are *components of a system*. Broadly, we support reducing impediments to substitution between different products (e.g. product A for product B) and (at least in theory) substitution between different systems (system X for system Y), but the caveat must be that they objectively are proven to meet the performance requirements and deliver the original design performance.

2.13 However, for the following reasons, we do not support substitution of products *within* a system that has been tested and sold as a complete system.

(a) A system is a collection of building products that provides the performance required by the Building Code. To illustrate, the acoustic performance of a wall will be a function of several component products all working together to deliver performance. There will be a barrier and/or an energy absorber combined with structural elements that hold the wall up. All these products must work together to achieve the performance required by the Building Code. Suppliers of these systems have designed these systems to perform as a whole, had them tested to confirm they meet / exceed the relevant performance metrics, and accordingly will be willing to warrant that those systems will achieve that performance level.

(b) Substituting component products of a system without affecting performance is not straightforward. It is important to understand what factors and/or components in the system are governing the

[9] Draft Recommendation 4.

[10] Draft Report, paras 9.53.2, and 9.55.

[11] Draft Report, para 9.54.

[12] Draft Report, para 9.53.1.

system performance before a substitution can be made. The result is that a re-testing of the system for performance with the substitute product in place would need to be mandated as a pre-condition before any product can be allowed to be substituted into a system. That comes at a cost which the supplier (or purchaser) of the substitute component would need to bear. A complexity then arises as to warranties, given the supplier of the original system is unlikely to (and nor should they be expected to) warrant a modified system with substitute components as they will not have tested the system's performance with the substitute component in place.

(c) A simple example illustrates this issue.

(i) Suppose a structural bracing system uses a panel product to provide lateral stiffness. The system's performance is tested using specific fixings that fix the panel to the framing to ensure the system is appropriately ductile when subjected to seismic loads.

(ii) Now suppose that non-system fixings are substituted, and that those fixings are, objectively, 'stronger' than the fixings used in the system. On its face, that substitution would seem appropriate and low risk. However, the reality is that the stronger fixing may be less flexible before fracture or may cause irrecoverable damage to the panel at an earlier stage of seismic loading. This would result in decreased ductility and early failure of the system. Changes to the ductility of a system can result in premature failure of not only the system, but also other components in the structure.

(d) Therefore, even when a product may be viewed as objectively superior (on a standalone basis) to a product used in a system, substituting that product may undermine the overall performance of the system.

2.14 It is for these reasons we support recommendations that remove impediments to product and system substitution, but we do not support substitution of *components* within a system.

Investigating whether the barriers to certification and appraisal can be reduced.[13]

2.15 Consistent with our earlier submissions, we agree with the Commission that the CodeMark and BRANZ approval processes involve significant time and cost and can disincentivise entry.[14] We therefore support the Commission's recommendations:

(a) to review the cost structure of the CodeMark scheme, or introduce a streamlined certification process for low-risk products; and

(b) provided the benefits were sufficient, for the Government to consider contributing directly to the cost of certification and/or BRANZ appraisal.

3. Draft recommendations to support sound decision making

3.1 We agree with the Commission that there is scope for improving decision making in the certification and consenting processes.

3.2 We therefore support the Commission's draft recommendations to establish:

(a) a national key building products register as a centralised repository for sharing information about building products; and

[13] Draft Recommendation 5.

[14] Draft Report, para 9.60.

(b) a Building Consent Authority (**BCA**) centre of excellence to facilitate a better co-ordinated and enhanced approach by BCAs to consenting and product approval processes,[15]

provided they are universal to all building products, funded by the Government, and that the costs are not passed on to consumers. While we believe the Commission's recommendations will make a positive contribution in this regard, the effectiveness and efficiency of New Zealand's consenting systems should continue to be reviewed at suitable intervals and any opportunities for improvements identified.

3.3 We remain of the view there is substantial scope for consolidating the number of BCAs.

3.4 Consistent with our submissions to date, we continue to support:

(a) raising the hurdles to liquidating a company to temper the ability of builders and developers to incorporate limited liability companies specifically (or unintentionally) for the purpose of a single build or development; and[16]

(b) exploring a requirement that a Guarantee and Insurance Product be put in place for all residential new builds and alterations over a certain monetary threshold. While we acknowledge the Commission's comments on MBIE's work on the impact of liability and insurance on BCA risk aversion and economic efficiency,[17] we remain of the view that the impact of risk and liability settings is an area that warrants further investigation. [18]

3.5 We support the recommendation in relation to the MultiProof system. However, there are some critical issues which we believe need to be resolved to 'move the dial' in relation to off-site manufacturing, most notably removing the requirement that Licenced Building Practitioners (**LBPs**) also be used in the off-site context. Off-site manufacturing is a tightly controlled process occurring in a standardised environment, which means the concerns in relation to the structure and weathertightness of residential homes (which drive the requirement for LBPs in the 'normal' on-site context) are better addressed via the design and implementation of the (repeatable) manufacturing process rather than mandating requirements for what are essentially operators of a manufacturing plant.

3.6 Finally, turning to broader, non-sector specific regulation, we also agree with the Commission that carbon-reduction policies, such as the Emissions Trading Scheme (ETS), have the potential to distort competition, and that the "Government should continue to have regard to any potential competitive effects of these reforms, minimising competitive distortions where possible".[19] As the Draft Report notes, this view was also expressed by the Infrastructure Commission in its 2021 Infrastructure Resources Study report.[20] In our view, the importance of avoiding any such distortions is particularly important given the clear benefit to New Zealand of retaining domestic cement manufacturing capability.

4. Draft recommendations to address strategic business conduct

4.1 Our perspectives on Draft Recommendations 7 ("promote compliance with the Commerce Act, including by discouraging the use of quantity-forcing supplier-to-merchant rebates that may harm competition") and 8 ("further consider the economy-wide use of restrictive land covenants and exclusive leases") differ from the Commission's, at least in part.

[15] Draft Recommendation 6.

[16] Fletcher Building Limited *Submission on regulatory barriers to entry or expansion*, para 5.5.

[17] Draft Report, paras 3.137-3.148.

[18] Fletcher Building Limited *Submission on regulatory barriers to entry or expansion*, para 5.3.

[19] Draft Report, para D69 and D77.

[20] New Zealand Infrastructure Commission, Te Waihanga "Infrastructure Resources Study" (11 November 2021) at 12, available at: https://www.tewaihanga.govt.nz/assets/Infrastructure-Resources-Study-11-Nov-21.pdf.

4.2 We agree that legislative changes to prohibit types of rebates are not justified.[21]

4.3 We also agree the Commission should be vocal and clear in promoting compliance with Part 2 of the Commerce Act – particularly the amended section 36. As the Commission itself recognises in its Enforcement Response Guidelines, most businesses and individuals want to comply with the law, and the Commission's role is to assist them to comply by educating and engaging with market participants.[22] However, in doing so, the Commission should ensure that large suppliers into New Zealand markets, but which are headquartered overseas, are similarly targeted in terms of stakeholder outreach. That may require a more targeted approach given their focus will typically be on their home markets.

4.4 We therefore encourage the Commission in its intention to provide guidance on its view on how the new section 36 will apply.[23] High quality guidance from the Commission, which recognises the nuances associated with distinguishing pro-competitive rebates from those which, in the Commission's view, raise potential competition issues, will assist participants in both the building products sector and across the wider economy. This is critically important given, as the Commission notes, the widespread use of retroactive volume rebates to recognise customer volumes, not to mention that the effect (or not) of these rebates on competition has been a matter of great debate among regulators, economists, academics, practitioners and the courts for more than well over a decade.

4.5 Accordingly, if the Commission genuinely believes the substantial lessening of competition test in the new section 36 is likely to lead to an enhanced enforcement response, then the level of guidance and engagement will need to be more extensive and detailed than might otherwise be provided – involving all sectors of the economy (including importers), given the ubiquitous nature of such rebates and also the range of views internationally.

4.6 The Commission notes that certain types of rebates "may harm competition". Part 2 of the Commerce Act proscribes conduct that is anti-competitive and unlawful. We agree that unlawful conduct cannot be permitted. However, to the extent that the Commission's recommendations imply that the Commission will seek to discourage conduct that is not a breach of Part 2 of the Commerce Act, we disagree. Simply put, we do not believe it is the Commission's role to apply an additional subjective regulatory lens to conduct that does not itself breach Part 2 of the Commerce Act.

4.7 With respect to rebates specifically, as the Commission recognises, all types of rebates result in lower prices, which is of benefit to consumers. The Commission says it believes some of these rebates may harm competition in limited circumstances.[24] What the Commission describes as "quantity-forcing" rebates are referred to as loyalty or fidelity rebates in other jurisdictions, and in 2014 the Commission considered the impact of such rebates in this industry.

4.8 As the Commission acknowledges, in 2014 it investigated whether Winstone Wallboards' rebates amounted to a breach of the Commerce Act. The Commission concluded they did not. In doing so, not only did the Commission conclude Winstone Wallboards' rebates did not breach the current section 36 of the Commerce Act, but also that the rebates did not substantially lessen competition in the market (which is the new section 36 test).[25] Rather, the Commission concluded (at para 18.2):

> … there are other factors that appear to have limited rival plasterboard suppliers' entry and expansion, including:
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> 18.2.1 Building Code compliance (for plasterboard products used for bracing);

[21] Draft Report, para 9.89.

[22] Commerce Commission *Enforcement Response Guidelines* (October 2013) at para 11.

[23] Draft Report, para 9.92.

[24] Draft Report, paras 9.87 and 9.89.2, for example.

[25] Commerce Commission *Investigation into Winstone Wallboards Limited*, (22 December 2014), (**WWB Report**) para 19.

18.2.2 GIB being the preferred product of those involved in the designing, consenting and building of houses, including for obtaining the necessary building approvals from councils;

18.2.3 rival plasterboard suppliers not appearing to offer major merchants sufficiently compelling prices to compensate for the risk of dual stocking; and

18.2.4 the existence (at least until recently) of import duties on plasterboard.

4.9 Winstone Wallboards confirms that it has made no changes to its rebate structures since that investigation that would undermine the Commission's 2014 conclusions that the rebates did not substantially lessen competition. If these rebates do not breach the Commerce Act, our view is that it is not the Commission's role to discourage their use.

4.10 Our position is similar in relation to restrictive land covenants and exclusive leases. If a covenant or lease breaches the Commerce Act, it will be unlawful and the Commission should seek to remedy that loss of competition, as it says it is in one such situation. However, such covenants and exclusive leases are widespread across a range of industries and settings, and, except in rare instances, will not have any meaningful impact on competition. That said, we do not oppose the Commerce Commission or MBIE reassessing whether the regulatory settings for covenants and exclusive leases (including Part 2 of the Commerce Act) are achieving the most efficient use of land in New Zealand, provided that review is (as the Commission suggests) across all firms and industry sectors. For our part, we utilise these tools when available and appropriate, but will not object to their removal from the system if the whole economy is required to change.

5. Other

5.1 While we agree with a number of the Commission's conclusions (including, for instance, that "vertical integration does not appear to make it harder for suppliers to compete"[26]), unsurprisingly we do not agree with them all. Some of our concerns are relatively detailed and product specific[27], and others less so. The latter category includes the following.

(a) **The implications of 'tried and tested' products:** As is the case in all markets, all things being equal, it is rational for consumers (be they specifiers, builders or otherwise) to choose 'tried and tested' products – and they do so for a compelling reason. It is inherently a 'good' thing that consumers have available 'tried and tested' products, as they reduce search costs and create other efficiencies. Indeed, in all markets it is often the case that new products do not succeed because they do not offer customers anything over and above the products supplied by the incumbents. We therefore encourage that any recommendations and policy responses aimed at facilitating the entry of new products genuinely add to the options available and do not impose a cost on architects, specifiers, BCAs or other industry participants (be it delay or financial cost), because those costs will inevitably be passed onto New Zealanders. Put another way, facilitating the entry of new products is one thing (e.g. by making it easier for specifiers and others to identify whether or not a product is suitable for a particular use), but to do so by constraining the ability of, or making it more difficult or costly for, specifiers and/or other industry participants to specify the products they wish, including because they are 'tried and tested', is another.

(b) **CSQs:** The Commission's Merger Guidelines describe competition as "the process through which firms compete to win customers based on price, quality, service or any other dimension of

[26] Draft Report, para 5.112.4.

[27] For example, we disagree with the comment in D55 that New Zealand's cement standards are more stringent than many international standard specifications, with the Commission noting the New Zealand and European soundness requirements. The relevant New Zealand standard is a copy of the Australian standard which for general purpose cement limits expansion to 5mm. We expect this came from an older British standard, which set soundness at <5mm, and would have likely also been the case in most Commonwealth countries. It is true that soundness issues can arise where cement is being made from dolomitic limestone, which does occur in isolated locations around the world, in which case you will tend to have soundness numbers of 7-10mm. But this is comparatively rare, such that we believe there would be more cement made globally with soundness below 5mm than above (with cements most often have soundness values of 1-2mm).

competition"[28]. CSQs are one means via which firms fight for market share – in some cases, they are a mechanism to reflect a customer's volumes or lower the cost to serve, and in other cases they are to match or otherwise react to a competitor's pricing. In short, they reflect competition at work. Accordingly, and absent below cost predatory behaviour, we consider it would be inappropriate for a competition regulator to recommend that incumbent firms should somehow 'pull their punches' and price higher than they would otherwise do, to afford competitors an easy ride. That would be contrary to long-standing principles of competition law, which make clear the focus must be on the protection of the competitive process (in which there are winners and losers) rather than the protection of individual competitors.

(c) **Innovation:** We believe the Commission has significantly underestimated the extent of innovation we have brought to the markets in which we operate. We are concerned to avoid an assumption that innovation will necessarily be low in what have been termed concentrated markets, and hence we set out below additional examples, over and above those outlined in our response to the Commission's Preliminary Issues Paper.

(i) That plasterboard can be used as a bracing element in New Zealand has been described as a 'problem'. In our view, it is quite the opposite: New Zealand's performance-based Building Code has permitted alternative solutions to achieve structural lateral bracing, *provided they meet the performance requirements.* NZS3604 provides designers with the means to calculate bracing demand and it also nominates a test method P21, to which any proposed bracing system can be tested to demonstrate its bracing performance. This then becomes part of an Alternative Solution, and any system provider (whether they use plywood, fibre cement, built-in bracing, plasterboard or otherwise) needs to demonstrate bracing system performance. Winstone Wallboards' plasterboard bracing systems have been developed and tested to meet these performance requirements. Winstone Wallboards' investment in this innovation should be celebrated as one which has led to lower overall building costs, rather than the choice to use plasterboard bracing systems being held out as conferring some form of unfair advantage on Winstone Wallboards.

(ii) Similarly, Winstone Wallboards could have chosen to simply follow overseas markets where plasterboard is made to a 'standard', whether this be for fire, acoustic, wet areas or any other desired performance attributes. Winstone Wallboards instead looked to innovate to optimise the value delivered in the systems developed, to ensure consumers had the best possible performance at the most economical price. For instance, a comparison of Winstone Wallboards' fire rated systems and the various performance levels these have achieved with competitor offerings from overseas reveals that Winstone Wallboards has innovated to provide a similar level of performance with typically less material. As an example, in markets where generic products are typically supplied, two layers of plasterboard might be required to deliver the equivalent fire performance.

(iii) Golden Bay Cement has made substantial advances in the use of waste products to fuel its cement kiln. Currently, Golden Bay Cement's Portland plant substitutes ~50% of its coal requirement with alternative raw material (e.g. waste wood and end-of-life tyres otherwise destined for landfills). In terms of these waste materials, the plant currently uses approximately 65,000 tonnes of wood waste per annum and 3,000,000 end-of-life tyres per annum that would otherwise be destined for landfill, providing an innovative solution to help address New Zealand's waste issues.

We trust these comments have been helpful, and we remain available to engage with the Commission over the balance of this process.

[28] NZCC Mergers and Acquisition Guidelines 2022 at para 2.18.