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Commerce Commission

Attention Anthony Stewart

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Cavalier Wool Holdings - Response to issues raised at the Commerce Commission's Conference on 4 - 6 May 2011

Cavalier Wool Holdings Limited (**CWH**) believes that none of the opinions or views expressed by third parties during the conference held on 4 to 6 May 2011 should cause the Commerce Commission to change the preliminary view it expressed in the Draft Determination that the benefits to the public would be likely to outweigh the loss of competition arising from the acquisition.

Attached as an Annexure is CWH's response to issues raised by third parties at the conference (based on information on the record as at the end of the conference) and the further information requested by the Commission. A report from NERA providing the further analysis requested by the Commission is also **enclosed** with this letter.

1. **Little or no evidence provided to support assertions made**

   Many of the views and opinions expressed by third parties were backed with little or in many cases no supporting empirical evidence. Various theories were espoused with little reference to the actual facts of this case. New Zealand's courts have previously warned against "assuming inefficiencies on grounds of economic doctrine" or "relying on purely intuitive judgment".

   The Commission will look at the facts before it and determine whether, on the balance of probabilities, there is a real chance of public benefits arising from the acquisition.

2. **Evidence on the record demonstrates public benefits likely to result from the acquisition**

   The variation to the Application filed by CWH on 12 May 2011 conclusively removes any risk that the benefits claimed will not be realised.

   The evidence conclusively demonstrates that not only is there a "real chance" of public benefit resulting, but that there is in fact a high degree of certainty that such benefits will result.

   Indeed, with the exception of the quality benefits, there was little debate about whether benefits of the type claimed were in fact public benefits; the only real debate was to the extent of those benefits.

Moreover, the evidence presented (on balance) reinforces the appropriateness of the Commission's preliminary view. Specifically:

- There was agreement in principle that if the calculated cost savings represented a reduction in "inputs" to achieve the same "outputs" these were real cost savings for New Zealand. CWH confirmed in evidence that the cost savings arise from a reduction in units, and not a reduction in price.

- There was no dispute that the sale of land was a relevant benefit. Nothing presented by WSI should cause the Commission to revisit the value it assessed. If anything, CWH continues to believe the amount specified in the Draft Determination is conservative. The sale will be achieved in year 1.

- There was clear widespread support for the establishment of a wool superstore and the benefits it would create. There was also support for the view this would not happen absent the acquisition.

- There seemed no debate that if CWH had improved its base Y value by doing things WSI had not done and could not do, this would be a benefit of around 4 cents per kg. Third parties asserted that there was no evidence that WSI had not achieved these benefits but have to date declined to produce the independent test data which is within WSI's control to provide. WSI have agreed to procure this data; but, if they fail to do so or if the data is not based on independent test house (as was CWH's data), the Commission would be entitled to infer from that failure that the correct data does not support the assertions made.

- No evidence was presented that cast doubt on the Commission's assessment of competitive detriments. If anything, the evidence indicated that the detriments would be at the low end of the scale identified by the Commission. CWH submits that:

    - the evidence was clear that the primary drivers for CWH to achieve productive and dynamic efficiencies would remain if it acquired WSI; and

    - the evidence was also clear that price increases of the type advanced by third parties – now up to 40% over current prices – were simply unrealistic and unsupported by compelling empirical analysis. But one example was Futures Consulting Limited's new entry model which was shown to be highly sensitive to a few key assumptions for which there was simply no factual support. Indeed, tweaking 3 or 4 assumptions to reflect market place reality reduced Futures' implied price increase from 12.5 cents to **[REDACTED]** cents.

3. **The position of WSI and the views expressed by its officers**

The example of Futures' new entry model illustrates the caution which, in CWH's submission, the Commission should exercise in placing weight on the views and opinions expressed by WSI's management and officers.

The WSI officers were openly and aggressively antagonistic to the transaction; their positions have consistently changed and CWH submits the views expressed have been informed more by their personal feelings rather than as officers cognisant of the interests of all WSI's shareholders. This has all manifested in an apparent strategy of seeking to confuse rather than assist the Commission.

CWH submits this caution extends equally to the four "independent expert" evidence WSI introduced. With the exception of Dr Layton, the other three experts stand to lose regular revenue if the transaction proceeds as, in each case, WSI appears to be a major client.

CWH is happy and able (at short notice) to provide any further information to the Commission on any of the matters raised in this submission.

Yours sincerely

[Sgd: Phil Taylor / David Blacktop]

Phil Taylor / **David Blacktop**
Partner / Senior Associate

Enc.

Annexure: detailed submissions

1. Relevant provisions of the Commerce Act

1.1 The authorisation sought

CWH has applied for an authorisation under section 67(1) for it or any interconnected body corporate to acquire all of NZWSI's wool scouring assets[1] and/or any interconnected body corporate of NZWSI that holds any of those wool scouring assets (the **Acquisition**).

Section 67 provides the statutory mechanism by which authorisation may be given to a person proposing to acquire the assets of a business or shares. Section 67(3) provides:

> ... the Commission shall—
>
> (a) If it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market.... give a clearance for the acquisition; or
>
> (b) If it is satisfied that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted.....grant an authorisation for the acquisition; or
>
> (c) If it is not satisfied as to the matters referred to in paragraph (a) or paragraph (b) of this subsection.....decline to give a clearance or grant an authorisation for the acquisition.

Counsel for Godfrey Hirst made a submission that an authorisation is an "indulgence"[2]; this submission is incorrect and finds no support in the statutory scheme or the applicable case law. Authorisations simply embody Parliament's intention that maximising economic efficiency is the primary objective underlying the Commerce Act. Accordingly, the characterisation of an authorisation as an indulgence is legally misconceived and should be disregarded.

This was explained by Cooke P in *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429 (**AMPS-A**) at 438:

> By its long title the Commerce Act is an Act to promote competition in markets within New Zealand. That does not imply that unlimited competition is to be pursued at all costs, however wasteful of resources. If a reasonable amount of competition is being promoted, as it is in this field, the public detriment from excluding further competition may not be serious and may more readily be outweighed by the public benefit of economies of scale and other efficiencies.

1.2 Assessment of detriments

The structure of section 67(3) provides an analytical process for considering authorisation applications:

- Sub-section 67(3)(a) provides that the Commission must first consider whether 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. If it is so satisfied, it must grant a **clearance**.

[1] Being the wool scouring assets and stock located at Whakatu and Kaputone and 50% of the shares in Lanolin Trading.

[2] Per Mr David, T 4 May, 74: 8 and T May 5, 87: 4.

- It is only if the Commission cannot be so satisfied, that the question of an authorisation arises.

- Sub-section 67(3)(b) provides that the Commission must consider whether, notwithstanding the finding of a substantial lessening of competition in a market (or the failure to exclude the real chance of that outcome occurring), the acquisition "will result, or will be likely to result, in such a benefit to the public that it should be permitted".

- If it is satisfied that it is likely that it will result in such a benefit, then it must grant authorisation; if it is not so satisfied it must decline authorisation.

The deliberate decision by Parliament to structure section 67(3) in this way has implications for the way in which detriments fall to be assessed.[3]

It is only those detriments which arise in the market in which the identified substantial lessening of competition occurs that are relevant in the public benefit calculus.

This is consistent with the clearance regime itself. To illustrate, where a transaction is found by the Commission not to substantially lessen competition in market A, clearance cannot be declined because of an impact in market B unless that impact in itself substantially lessens competition in market B.

The same fundamental approach applies in respect of authorisations. Detriments arising in the market where there is an identified substantial lessening of competition are weighed against public benefits.

This is the approach which has been consistently applied by the Commission and the Courts. See, for example:

- The Commission's decision in *Air New Zealand / Qantas* (at paragraph 897):

> [T]he authorisation procedures under ss 61(6) and 67(3)(b) are the same. Both require, as a result of the Commission's findings of a substantial lessening on competition for the Commission to identify and weigh the detriments likely to flow from the lessening of competition in the relevant markets, and to balance those against the identified and weighed public benefits likely to flow from the proposed Alliance as a whole. **It is important to note that the detriments may only be found in the market or markets where competition is lessened, whereas benefits may arise both in those and in any other markets**. Only where the Commission is satisfied that the benefits outweigh the detriments would it be able to grant an authorisation for the Acquisition and Arrangement proposals. (emphasis added)

  This was not overturned in the High Court which recorded that the tests for authorisation of a restrictive trade practice and a business acquisition were "substantially the same".[4]

[3] This structure is different from the authorisation process for business acquisitions and RTPs in Australia. Under the Competition and Consumer Act 2010, the Australian Competition Tribunal rather than the ACCC has jurisdiction to grant authorisations. The Tribunal has no ability to grant a clearance. Therefore, the sole test is whether there are benefits to the public and there is no threshold question as to whether there is a substantial lessening of competition. Prior to the introduction of a formal clearance process, authorisation applications were made directly to the ACCC.

[4] *Air New Zealand v Commerce Commission* (2004) TCLR 347, para 33.

- Justice Wilson's observation in *New Zealand Bus Ltd v Commerce Commission* [2008] 3 NZLR 433 (CA) at paragraph 271:

> ... As a counterpoint to the adoption of the low "substantial lessening of competition" test, the Act in s 67 permits the Commission to authorise an acquisition which is likely to have the effect of substantially lessening competition if the public benefits resulting from the acquisition outweigh the detriments caused by the substantial lessening of competition. **As the Commission correctly held** in *Re a Proposal by Goodman Fielder Ltd* (1987) 1 NZBLC (Com) 104,108, at p 104,147 and in *Re Air NZ Ltd & Qantas Airways Ltd* 23/10/03, Rebstock P, Chairman, Commerce Commission Decision No 511, at para 897, **all benefits must be taken into account whereas only detriments in a market where competition is lessened will be relevant.** (emphasis added)

- The Commission's Draft Decision in the *Dairy Co-op case* (paragraph 441):[5]

> It is important to note that because of the wording of the Act, the detriments may only be found in the market or markets where dominance is acquired or strengthened, whereas benefits may arise both in those and in any other markets.

- The Commission's decision in *Ruapehu Alpine Lifts* (paragraph 234):

> The authorisation procedure requires the Commission to identify and weigh the detriments likely to flow from the acquiring of a dominant position in the relevant markets, and to balance those against the identified and weighed public benefits likely to flow from the proposed acquisition as a whole. **It is important to note that the detriments may only be found in the market or markets where dominance is acquired or strengthened, whereas benefits may arise both in those and in any other markets**. Only where the benefits clearly outweigh the detriments can the Commission be satisfied that the proposed acquisition will result, or be likely to result, in such a benefit to the public that it should be permitted, and thus be able to grant an authorisation for the proposed acquisition.

- The decision of the High Court in *New Zealand Co-operative Dairy Co Ltd v Commerce Commission* [1992] 1 NZLR 601 at 631 (HC):

> That decision also held, correctly in our view, that by the introduction of the word detriment into the authorisation test it was intended that the Commission has a duty "to assess, as far as practicable, the degree of competitive detriment likely to flow from the acquisition or strengthening of a dominant position" and went on to say:
>
> > Similarly, with respect to mergers or takeovers, the Commission considers that it must comprehend the degree of detriment likely to be associated with the risks which, by definition, flow from dominance. Otherwise, the Commission could unfairly prejudice a proposal by, in effect, assuming that the risks, and hence possible adverse effects, were so open-ended as to be unlimited.
>
> This need not be the case. ... To infer that the risks of dominance were unlimited could unfairly prejudice a merger or takeover proposal (and any potential for net efficiency gain), since sufficient public benefit would always be impossible to find.
>
> We agree with the Commission's conclusion in that case that the application of the authorisation test should involve an assessment of "the likely degree of detriment, arising from the acquisition or strengthening of dominance". This involves an evaluation of the limits of that detriment.

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[5] As Mr David correctly noted at the hearing, the Commission in assessing efficiency losses in that Draft Determination excluded "butter" from its estimates of revenue on the basis that it did not see the transaction as giving rise to dominance concerns in the butter market. This illustrates the correct principle.

That is not to say that vertical integration impacts are irrelevant to the Commission's assessment. However, those impacts are to be assessed at the initial stage in answering the question as to whether the acquisition is likely to result in a substantial lessening of competition in any market:

- If the vertical impacts do amount to a substantial lessening of competition in a market, then the detriments from that lessening of competition are relevant.

- If the vertical impacts do not result in a substantial lessening of competition in that market, then no detriment falls to be assessed.

Accordingly, section 67(3) requires the Commission to identify any market where it cannot be satisfied a substantial lessening of competition will not, or will not be likely to arise. Having done so it must assess the detriments associated with a substantial lessening of competition in those markets and only in those markets. It is against those detriments that the public benefits arising in any market must be measured.

In CWH's submission, the Acquisition does not give rise to a substantial lessening of competition in any market other than those identified by the Commission in the Draft Determination. As a result, the detriments to be considered in the balance in this Application are only the detriments arising in those identified relevant markets and in no others.

1.3 Public benefits

The principles applying to a calculation of public benefits are well settled and were stated most recently by the High Court in *Air New Zealand* at paragraph 319:

- Benefits include efficiency gains (s 3A of the Act) and anything of value to the community generally.

- Only net benefits are included. Any costs incurred in achieving efficiencies must be taken into account. Transfers of wealth which achieve no benefit to society as a whole should be disregarded.

- The benefits must result from the acquisition or arrangement. Benefits which would or would be likely to accrue whether or not the proposed acquisition proceeded should be disregarded.

- Benefits should be quantified if possible but benefits which, by their nature, are incapable of quantification should still be taken into account.

1.4 A fact based assessment

The assessment of benefits and most importantly detriments is a fact based assessment. Assumptions of inefficiency should not be made on the grounds of economic doctrine alone (see *AMPS-A*, per Cooke P "Parliament has expressly directed in s 3A that efficiencies are to be taken into account. In my view that direction should not be effectively (albeit unintentionally) circumvented by assuming inefficiencies on grounds of economic doctrine.").

1.5 The standard of proof and "likelihood"

Interested parties at various times referred during the conference to the need for the Commission to be "certain" or to have a "high degree of certainty" or even to be satisfied

"beyond reasonable doubt"[6] that the authorisation will result in a public benefit. These assertions are without foundation and misstate the statutory test for authorisation.

It is settled law that the standard of proof under section 67 is the civil standard of balance of probabilities.[7]

Section 67(3)(b) requires the Commission to be satisfied on the balance of probabilities that the acquisition "will result, or will be likely to result, in such a benefit to the public that it should be permitted".

The High Court in *Air New Zealand* referred to this test of "likely to result" as requiring the Commission to look to "probable outcomes rather than possible or speculative effects".

It is relevant that in section 67(3)(b) the "likely" outcome which the Commission is to look to is whether there are benefits to the public.

This is different to the merger clearance context in section 66 where the "likely" outcome is a substantial lessening of competition. Under the structure of section 66, the Commission is required to decline clearance if it cannot exclude the likelihood of a substantial lessening of competition.

This difference is illustrated by the judgment of Panckhurst J and Professor Lattimore in *Ravensdown Corporation Ltd v Commerce Commission* (High Court, Wellington, AP 168/96, 9 December 1996), a case concerning a merger authorisation (emphasis added):

> The Commission must be satisfied `that the acquisition will result, or will be likely to result, in such a benefit to the public that it should be permitted . . . '. **This means that the Commission must be satisfied of at least the likelihood of benefit to the public, resulting from the acquisition, before authorisation is appropriate. It is that end result which must be likely**. As to the meaning of likely see the review of the authorities undertaken by McGechan J in *Commerce Commission v Port Nelson* (pp 429 — 432), and the shorter Court of Appeal analysis by Gault J at the appeal stage in *Port Nelson v Commerce Commission* (p 226). What is required is that the Commission make a facts-based assessment of benefits and detriments, adopting a quantitative approach where possible, and **on the basis of that assessment decide if it is satisfied the acquisition is at least likely to result in such benefit to the public that it should be permitted. In short, the test of likelihood is to be applied at the end of the process**.

In other words, the Commission's role is to assess benefits and detriments and then assess whether it is likely that the benefits exceed the detriments.

It is clear from this passage that "likely" in terms of section 67 is not to be interpreted differently than it is in other contexts of the Commerce Act, i.e., an outcome is "likely" if there is a "real and substantial" chance that it will occur or that there must be a "real chance" that it will occur.

Accordingly, section 67(3) requires the Commission to determine, on the balance of probabilities, whether it is satisfied that it is more likely than not that there is a real chance that the acquisition will result in net public benefits. If it is so satisfied, it is directed to grant an authorisation. If it is in doubt as to whether there is a real chance the acquisition will create public benefit, it must decline.

[Deleted section 2 – 3.2]

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[6] **[REDACTED]**

[7] *Commerce Commission v Southern Cross Medical Care Society* (2002) 10 TCLR 269 (CA), para 7; *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347.

3.3. Land value

It remains CWH's position that the value of the land and buildings are $**[REDACTED]** million. CWH believes the Commission's preliminary view that the lowest value that should be ascribed is $8.792 million is a conservative approach.

There was no apparent dispute among parties that the selling of the land and buildings at Whakatu and Kaputone is a benefit,[8] the issues were confined to the quantum of that benefit and when a sale would occur.

(a) ***Value of the properties***

WSI's argument that the value of the buildings is much lower than is recorded in their financial statements and in the Receivers' IM and that the properties should be valued on a "vacant possession basis" should be rejected.

WSI's argument rests on the premise that the buildings should be valued on a "vacant possession basis" which they say in relation to Kaputone is much lower than the value recorded in WSI's accounts.

When a property has a significantly lower "vacant possession" value this implies that the property is specialised to its current use such that when the scouring equipment is removed (as it will be following the relocation of the scours) a replacement tenant could not easily be found or could only be installed with significant changes to the building. **[REDACTED]**.

WSI has submitted a report from Dr Alan Reay in which he expresses the opinion that "the buildings on the two sites have been purpose built for use as scours and associate wool stores and that their economic use for other industrial or commercial uses would be very limited".

CWH's concerns in relation to this report have been outlined but in any event it is not clear that Dr Reay has the expertise to discuss the potential usage of the buildings rather than their construction.

Dr Reay's opinion is contrary to CWH's experience with previous sales of wool scour sites, and its discussions with people with experience of the two sites.

In terms of its experience, CWH informed the conference that it or its officers have been involved in, or are aware of, the sale of eight wool scours over the last 15 years, the majority of which have been sold for uses outside of the wool industry.

The Commission asked for further information regarding these sales[9] and each of them is discussed below:

Clifton wool scour land and buildings (Godfrey	• Sold in the middle of the GFC for **[REDACTED]** million which was $**[REDACTED]** million above its "vacant possession" valuation of **[REDACTED]** and within 5% of the going

[8] T 5 May, 21: 9-10.

[9] T 5 May, 34: 13-14.

Hirst transaction, 2009)	concern value.[10]
	• CWH had to fill the drains and ducting holes in the floor and repair a wall that was damaged getting out equipment. Total cost was under $100,000 which was more than covered by the sale of scrap and surplus equipment.
	• It is now used by a transport operator.
Winchester Wool Scour, Timaru (2006)	• Sold to and used by Paddon Direct, a supplier of farm machinery and equipment. The site is used for refurbishing imported farm equipment.
	• The site was sold for CWS's budgeted valuation.
Wanganui Wool Scour buildings (1996)	• Now used for furniture manufacturing.
	• CWH has no information on sales value.
E Lichtenstein Wool Scour (Onehunga) (2000)	• Now used for manufacturing.
	• This was sold within 12 months of the scour operation ceasing.
Seaview Wool Scour (2004)	• Now used for industrial warehousing.
	• CWH has no information on sales value.
Tomoana Wool Scour (1994)	• Now used by Heinz Watties for storage of cans.
	• CWH has no information on sales value.
Gisborne Wool Scour (2004)	• Now used as a woolstore for a private wool merchant.
	• CWH has no information on sales value.
Feltex Wool Scour (2007)	• Now used as a chicken processing factory and by an onion merchant.
	• CWH has no information on sales value.

Accordingly, there is ample experience which supports the view that scouring buildings are not highly specialised and there are a number of alternative economic uses. The "pits, coal bunkers, and other structures" that Dr Reay refers to as limiting the economic use of the scours are a common feature of wool scours and were certainly present at Clifton; these have not deterred previous prospective purchasers.

[10] T 5 May, 27: 5-8.

The Commission requested further information regarding what parties are likely to buy the properties[11] and the potential remedial costs for cleaning up the sites if the issues identified by Dr Reay are real issues.[12] CWH makes the following comments:

(i) *Re: Whakatu*

A potential user of the Whakatu site has already approached CWH expressing an interest in acquiring the site and the Commission has a note of its discussions with that user.

CWH has contacted four previous managers of Whakatu, one of these was the Manager through the building program in the 2004/2005 period and another was the Manager of the site up until approximately May 2009. All four managers have told CWH that the Whakatu building could be used for purposes other than wool scouring if the wool scour was relocated.

In his report Dr Reay stated that "the roof of the scour building at Whakatu is materially affected by corrosion due to the use of chemicals. It is likely that substantial sections of the roof of the building would need to be replaced due to corrosion taking a medium term view of the buildings".

The evidence from WSI at the Conference indicates this is incorrect; WSI representatives confirmed that the staining assumed to be corrosion was due to titanium dioxide being used.[13] While this left a brown stain on the roof, it did not actually corrode the roof as suggested by Dr Reay. WSI inferred this was correct.[14]

In any event, even if that section of the roof did need to be repaired, the cost would be negligible. CWH has measured the affected roof area by gaining the floor plans from the city council and by using aerial photographs of the site. CWH has had an indicative quote for what it would cost to repair this section of the roof (if it was needed) of $**[REDACTED]** plus GST.[15]

(ii) *Re: Kaputone*

While no party has yet made a proactive approach in relation to Kaputone as has happened in Whakatu, CWH does not consider it would have any difficulty in selling this property.

There remains a demand for buildings of the size of Kaputone in the industrial fringe of Christchurch. In response to the Commission's query regarding whether any approaches have been made for the Kaputone site,[16] there are a number of displaced operators in the transport, logistics, engineering and construction industries, who remain uncertain about their locations and many would consider Kaputone to be a potential option. These include:

- **[REDACTED]**

[11] T 5 May, 22: 21.

[12] T 5 May, 30: 1-6.

[13] T 5 May, 29: 5.

[14] T 6 May, 59: 14-17.

[15] T 5 May, 30: 17-18. This quote can be provided to the Commission if necessary.

[16] T 5 May, 24: 3-5.

There are also a number of parties looking at industrial land and buildings as development land is becoming a tradable commodity as businesses displaced by the recent earthquakes look for suitable space and compete with other potential tenants. Large industrial sites historically have interest from this sector and there is no reason to believe that Kaputone will be an exception.

Mr Stock, as Counsel for WSI, gave evidence about the existence of the unrelated adjacent disused meat processing site but no informed expert view was given and in CWH's opinion no reliance can be placed on the views expressed. Certainly there was no evidence to show that the disused processing site had any relevance to a nearby current scouring site.

Specifically in relation to the issues raised by Dr Reay:

(A) Cobbled floors

Dr Reay has made the statement that the "new storage building at Kaputone does not have a concrete floor as would be required for most purposes and uses, and instead has a cobbled floor".

CWH does not dispute that there is some cobbled floor, but understands the affected area is restricted to one very small storage shed and another area where the wool grease plant and amenities are. CWH does not believe that these areas are large enough, or in a critically located part of the building, to devalue the building greatly.[17]

However, even if for any reason the cobbled floor did require replacing, CWH has received a quote for a "pre-stressed floor" for $125 per m^2.

Pre-stressed flooring is suitable for a site with an insufficient base structure and is the flooring used at CWH's own Awatoto scour line under which there is no hard base.

(B) Subsoil conditions

Dr Reay makes the statement that "the subsoil conditions at Kaputone... are such that the bearing capacity of the subsoil limits the design load capacity of the floors to pneumatic forklifts of limited capacity and low level bulk storage".

This statement is incongruous with the CWH's understanding that there is a substantial crane structure inside the Kaputone buildings. CWH understands this structure is used to transport fully laden containers. This would indicate that there is a substantial building structure in place at Kaputone and suggests the concerns about the load bearing capacity of the floors are overstated.[18]

Overall, CWH submits:

- there is no reason to believe that the vacant possession value of the land is lower than the going concern value of the land; and

[17] T 6 May, 58: 27-30.

[18] T 6 May, 58: 30-32.

- the Commission should be cautious in placing any weight on the opinions offered by Dr Reay as his report is clearly aimed at advancing the WSI's management interests rather than being an application of independent expertise as required by the High Court Rules.

(b) ***Timing of sale***

The land will be available for a completed sale within 12 months of the acquisition. The rationalisation timeline is discussed in section 5 below.

CWH will market the properties prior to that time and expects that it would have sales agreements finalised such that there would be no or minimal lag between the site becoming available and a sale being completed. This is consistent with the Clifton sale, which occurred simultaneously with settlement of the main transaction.

In any event, while CWH recognises that if a sale took longer than one year to complete it would be appropriate to discount the future value received to present day terms, it would also be necessary to consider the fact that land values are likely to appreciate over time.[19]

[Deleted 3.4 – 3.6]

4. Competition analysis

4.1 Relevance of WSI as a competitive constraint

In section 2.2 of its submission in response to the Draft Determination CWH explained why in its view, at best, the WSI constraint, if it exists at all, is a weak, indirect, imperfect and uneven constraint which in CWH's view should not be given weight relative to the other constraints faced by CWH.

CWH explained that the much more significant and direct constraints for CWH are the risk of loss of greasy wool volumes to off-shore scouring facilities or the threatened loss to new entry, because each of those losses is likely to be permanent in nature and in practical terms unlikely to be capable of being regained.

None of the opinions or evidence proffered at the Conference cause CWH to change any of its views. WSI's primary focus appears to remain internal as it has always been.

(a) ***WSI's commission scouring volumes***

WSI representatives implied that its commission scouring volumes have increased significantly.

CWH does not believe the WSI volumes in fact reflect "commission scouring" but rather the sale of its own scoured wool to Godfrey Hirst and other local spinners. However, even if those numbers are correct, CWH estimates that WSI's share of the commission scouring market is **[REDACTED]**% in the North Island and **[REDACTED]**% in the South Island or **[REDACTED]**% of the New Zealand market.

[19] Submission on Draft Determination, page 10; T 5 May, 37: 30-33.

In any event, the suggestion that WSI's commission scouring has increased is in marked contrast to other statements made by WSI representatives during this process. During the initial interview with Commission staff, WSI stated that:

- its "commission scouring is increasing a little, but not as much as indicated by Cavalier" – in other words Cavalier had, in its authorisation application, overstated the competitive impact of WSI;
- "WSI has done some work for exporters over the last 12 months... but not a lot";
- their main customers were "**[REDACTED]**".[20]

It is unclear what has changed since February that would cause such a marked change in WSI's commission scouring volumes. CWH has certainly not noticed any rapid change since it filed its application for clearance.

As intimated above, CWH does not believe WSI's commission scouring volumes have increased significantly, however acknowledges that WSI might be selling its own scoured wool to Godfrey Hirst, **[REDACTED]** this is not commission volume.[21]

Accordingly, the most likely explanation for the increase is that WSI is counting sales of its own scoured wool to Godfrey Hirst as commission volumes. This is not true commission scouring, but rather the sale of scoured wool by the WSI trading division in the same manner as it sells wool to any other domestic or international customer. To illustrate, while CWH refers to Godfrey Hirst as its "customer", the actual wool that is being scoured is owned by merchants and exporters not Godfrey Hirst. It follows that the market shares implied by WSI's figures are materially overstated.

This view is reinforced by the fact that the volumes of commission scouring being claimed by WSI (which show an increase of some 30,000 bales between 2008/2009 and 2009/2010) are inconsistent with the scouring volumes WSI has asserted in discussions concerning the underwriting agreement (approximately **[REDACTED]** bales).

(b) ***Current prices to exporters not constrained by WSI***

Exporters have not attempted to leverage the WSI presence by actively splitting their scouring demand between CWH and WSI and most exporters remain strongly opposed to using WSI to scour their wool.

Despite this, and CWH's **[REDACTED]**% share of commission scouring, CWH has not been able to increases prices to these customers; Mr Crone confirmed this.[22]

It is of course notable that only one of the other major exporters felt this acquisition was of sufficient importance to them to make a submission on the Draft Determination, let alone attend the public conference.

This confirms some other material constraint is in play that effectively limits CWH in a real way at all levels of potential price increases, and it is not clear how removing WSI from the market will affect this constraint.

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[20] **[REDACTED]**

[21] **[REDACTED]**

[22] T 4 May, 15: 2-13.

[Deleted 4.2]

4.3 China and other markets

The Chinese market is not focussed on fine wool and only scouring fine wool and importing greasy coarse wool. CWH has provided material which demonstrates this is not the case. China is a growing market for all wool types including coarse wool in both scoured and greasy form. Mr Dwyer seemed to confirm this when he said:

> What this gentleman is talking about is the carpet wool market, in carpet wools going to China. The majority of New Zealand wool going to China is scoured for the carpet industry in China. So I don't think there's much to be won back.[23]

However, the evidence at the conference indicated that the constraint from markets such as China is wider in two respects.

First, there are other emerging markets which have their own scouring capacity and which are likely to increase in importance. Mr Whiteman stated that "In India, there's scouring capacity, so you might be better to put India in the same basket as China".[24] Over 6,000 tonnes of scoured wool is currently exported to India.

Second, there is the more indirect constraint caused by downstream competition:

- Mr Heath of Wool Equities said that in his view contract spinners in New Zealand cannot sustain any price rises because their competition is "in fact India or China or Portugal".[25]

- Ms Pauling from Godfrey Hirst referred to the possibility of relocating to China.[26] The loss of such a significant customer (over **[REDACTED]** tonnes per year) provides every incentive and impetus for CWH to keep prices down and service quality up so as to avoid that scenario.

In such a scenario a price increase by CWH would seem to be a self-defeating strategy. The impact of any strategy which led to such a loss would be devastating for CWH.

As Mr Pike stated, it is Godfrey Hirst's belief that "the sudden demise of wool scouring in Australia is more a result of the removal of the further processing industries in Australia to China which gave rise to the opportunity for the wool to be scoured in China".[27]

4.4 Price discrimination

The reality is that there is little in the way of price discrimination by destination today. If it was a profit maximising strategy, one would have expected CWH to have already adopted it given it is observed in other competitive markets (e.g., movie theatres).

The reason it does not occur today was explained by CWH at the conference. CWH has confirmed it has little knowledge of where wool is going to as its final destination, at least internationally, as most wool is hubbed through either Singapore or Hong Kong. What

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[23] T 4 May, 42: 8-11.

[24] T 4 May, 56:14-15.

[25] T 4 May, 53: 32 – 54:11.

[26] T 4 May, 29: 24-29.

[27] T 4 May, 11: 15-22.

information CWH does have is the information that customers provide to it. If customers did not wish them to receive this level of information, they could take steps to withhold it from CWH.

[REDACTED]

In relation to domestic users, **[REDACTED]**. However, even for other domestic users there would be opportunities for these customers to defeat any price discrimination by buying wool from exporters (in much the same way Godfrey Hirst does today) or through a wool exchange such as Abrahams Wool Exchange.

[Deleted 4.5 – 5.3 and confidential schedule]