

EXECUTIVE SUMMARY

Introduction

This is an application by Carter Holt Harvey Limited (**CHH**) for clearance for it, or any of its interconnected bodies corporate, to acquire the structural and industrial sawmilling business and certain assets of Lakesawn Lumber Limited (**Lakesawn Lumber**) (the **Acquisition**).

The Acquisition will result in horizontal aggregation between CHH's and Lakesawn Lumber's existing North Island structural and industrial wood products businesses.

The relevant counterfactual against which to assess the Acquisition is Lakesawn Lumber continuing to operate its structural and industrial sawmilling business.

Affected markets

For the purposes of this clearance application, CHH has analysed the impact of the Acquisition on the basis that there are North Island markets for the manufacture and wholesale supply of:

- structural timber; and
- industrial timber.

While in its most recent decision involving this industry the Commission defined separate structural and industrial timber markets, it has also recognised that the competition law impacts of an acquisition are likely to be the same in both markets given industrial timber is a by-product of structural timber production. Accordingly, this application focuses only on the impact of the acquisition on the structural timber market, although the arguments put forward apply equally to the industrial timber market.

Similarly, while CHH has used a North Island structural timber market in this application, CHH continues to face significant constraint from:

- South Island producers;
- Near entrants in other sawn timber markets (e.g., appearance grade manufacturers); and
- Producers of other building materials because structural timber competes (at an end-use level) with other products such as fibre cement, plaster, monolithic claddings, bricks, blocs, steel and concrete.

Accordingly, a North Island structural timber market should be viewed as a conservative starting point. CHH considers the market to be national in scope, although it does not consider that geographic market definition materially affects the competition analysis.

No substantial lessening of competition in North Island Structural Timber Market

Following the Acquisition, CHH's share of the North Island Structural Timber Market will be approximately [CONFIDENTIAL]%. That level of market share does not evidence a substantial lessening of competition because:

- The market is vigorously competitive, as accepted by the Commission previously;
- The market exhibits excess capacity in both the North Island and the South Island;
- There are a number of participants in the market capable of expanding and which do not face barriers to expansion – Red Stag being the most significant example;
- There are no barriers to new entry and there are a number of identifiable new entrants which would be likely to enter in a constraining fashion should prices increase above competitive levels; and
- Building supply chains account for a substantial portion of sales in the market, can exert substantial countervailing market power and have the ability to choose from many alternative suppliers and to promote expansion of any of them by the promises of contractual support. Even individual retailers have the ability to promote the expansion of quite small mills by the promise of contractual support, as was the case in respect of TDC.

Furthermore, as noted above, CHH notes that there are a number of other products that compete with structural timber at an end-use level (e.g. fibre cement, plaster, monolithic claddings, bricks, blocks, steel and concrete).

No substantial lessening of competition in North Island Industrial Timber Market

For the reasons outlined above, the Acquisition will not substantially lessen competition in the North Island Industrial Timber Market.

COMMERCE ACT 1986: BUSINESS ACQUISITION
SECTION 66: NOTICE SEEKING CLEARANCE

Date: 17 January 2007

The Registrar

Market Structure Team

Commerce Commission

PO Box 2351

WELLINGTON

Pursuant to s66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

PART I: TRANSACTION DETAILS

1. What is the business acquisition for which clearance is sought?

1. Carter Holt Harvey Limited (**CHH**), or any interconnected body corporate of CHH, seeks clearance to acquire the sawn timber business of Lakesawn Lumber Limited (**Lakesawn Lumber**) (the **Acquisition**).
2. Lakesawn Lumber is a member of the Pedersen group of companies (**Pedersen**) owned and controlled by Paul Pedersen and the Pedersen Commercial Trust.
3. CHH will acquire from Lakesawn Lumber:
 - (a) Lakesawn Lumber's stock of sawn timber at its Taupo sawmill;
 - (b) Lakesawn Lumber's customer lists, files and records;
 - (c) Lakesawn Lumber's supply contracts with customers; and
 - (d) certain specific plant and machinery.
4. Pedersen will retain its other existing businesses.
5. CHH is not acquiring all of Lakesawn Lumber's existing sawn timber plant and machinery. CHH already has existing surplus production capacity, which can absorb the volumes currently manufactured by Lakesawn Lumber while generating increased economies of scale. Other than the timber treatment plant, Lakesawn Lumber is contractually required to divest the sawn timber plant and machinery not required by CHH outside of New Zealand.
6. Pedersen's core business is and has been the provision of support services to the timber industry and in particular to CHH. Pedersen and CHH are currently parties to:
 - (a) a woodchip supply contract pursuant to which Pedersen supplies woodchip to CHH;
 - (b) a chipping and debarking agreement pursuant to which Pedersen supplies chipping and debarking services to CHH at its Kinleith Mill;
 - (c) an agreement pursuant to which Pedersen carries out all log yard services for Carter Holt Harvey Pulp & Paper Limited (**CHH P & P**) at the CHH site at Kawerau; and
 - (d) a roundwood agreement pursuant to which Pedersen supplies CHH with roundwood and associated products.

7. These agreements have been in existence for a number of years.
[CONFIDENTIAL]

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The Person Giving Notice

2. Who is the person giving this notice?

8. This notice is given by CHH.
9. CHH requests that all correspondence is directed in the first instance to:

Bell Gully
48 Shortland Street, Auckland
Telephone: 09 916 8800
Facsimile: 09 916 8801
Attention: Phil Taylor/David Blacktop
Email: phil.taylor@bellgully.com / david.blacktop@bellgully.com

Confidentiality**3. Do you wish to request a confidentiality order for:**

3.1 The fact of the proposed acquisition

10. No.

3.2 Specific information contained in or attached to the notice?

11. Yes. Confidentiality is sought for information contained in bold square brackets in this application (i.e., []).
12. The information that has been deleted is commercially sensitive and valuable information that is confidential to CHH. Disclosure of that information could result in material financial loss and prejudice to the competitive position of CHH and Pedersen. In this respect, CHH relies on section 9(2)(b) of the Official Information Act 1982. The foregoing applies equally in respect of all additional information (expressed to be confidential) that CHH may provide in relation to this application.

Details of the Participants**4. Who are the participants (i.e. the parties involved)?**

13. The participants are CHH and Pedersen.

CHH	Carter Holt Harvey Limited 640 Great South Road Manukau City Auckland Attention: Michael Falconer Chief Executive Carter Holt Harvey Wood Products
Pedersen	Pedersen Holdings Limited, Pedersen Industries Limited and Lakesawn Lumber Limited c/- Deloitte 8 Nelson Street Auckland Attention: Paul Pedersen Director

5. Who is interconnected to or associated with each participant?

5.1 Acquirer group/associates

14. CHH is a New Zealand incorporated company. It is a wholly owned subsidiary of Rank Group Investments Limited.

15. CHH is a wood fibre products company and carries on business activities in wood products, pulp and paper, packaging and building supplies. It produces wood products for supply to Australia, America, Asia, Europe and New Zealand. CHH operates six business divisions, namely:
- (a) Wood Products New Zealand;
 - (b) Wood Products Australia;
 - (c) Packaging – Carton;
 - (d) Packaging – Corrugated;
 - (e) Pulp & Paper; and
 - (f) Carters.
16. CHH produces structural and industrial timber for the New Zealand domestic market, as well as woodchips, which are a by-product of the milling process. CHH's wood products business includes its sawmills at Whangarei, Kawerau, Putaruru, Kopu, Rotorua (Rainbow) and Nelson.

Whangarei

17. In December 2006, CHH completed the acquisition of TDC Sawmills Limited. This acquisition provided CHH with a sawmill in the Northland region with a current log-in capacity of [CONFIDENTIAL]m³ per year. TDC had planned to expand this mill, and CHH intends to continue with this expansion. Following that expansion, the Whangarei mill will have a log-in capacity of [CONFIDENTIAL]m³ per year.

Kawerau

18. CHH produces structural timber at its Kawerau mill. Its current log-in capacity is [CONFIDENTIAL]m³ per year. CHH is undertaking de-bottlenecking of equipment at the mill and, once that project is complete, expects log-in capacity to increase to [CONFIDENTIAL]m³ per year.

Putaruru

19. CHH predominantly produces export timber, outdoor timber and pallet grade wood at Putaruru. Its current log-in capacity is [CONFIDENTIAL]m³ per year.

Kopu

20. CHH produces structural timber at Kopu. The predominant product is "wides", which are wider cuts of structural timber (i.e. 6 x 2 as opposed to 4 x 2). Kopu has a log-in capacity of [CONFIDENTIAL]m³ per year.

Rotorua(Rainbow)

21. CHH has historically produced roundwood and F7 structural timber at its Rainbow sawmill. However, CHH closed its sawmill at Rainbow in December 2005 and plans to decommission the secondary production facilities effective April/May 2007.

Nelson

22. CHH produces structural and outdoor timber at Nelson. Nelson's current log-in capacity is [CONFIDENTIAL]m³ per year.

5.2 Target company group/associates**5.2.1 Identify all subsidiaries of the target company and all companies in which the target company or any subsidiary owns 10% or more of the shares**

23. Lakesawn Lumber has no subsidiaries and does not own shares in any other company. The Pedersen companies of relevance to the Acquisition comprise Pedersen Industries, Pedersen Holdings and Lakesawn Lumber. Pedersen Industries is a contracting company and has a contract with CHH P & P to run its chipmills and log yards. Pedersen Holdings is an independent sawmiller with three divisions: a roundwood operation at Kinleith where all product is on-sold to CHH, a chipmill where all product is currently on-sold to CHH Pulp & Paper, and a forestry harvesting division. Lakesawn Lumber owns and operates a sawmill at Taupo, which produces structural and industrial timber.

5.2.2 If any company owns over 10% of the shares in the "target company", and will continue to do so after the proposed acquisition, then identify all of the interconnected bodies corporate of that company and all companies in which it or its interconnected bodies corporate own over 10% of the shares.

24. CHH will own the relevant assets of Lakesawn Lumber post-Acquisition.

6. Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant?

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25. No.

7. Identify any links, formal or informal, between any participant/s including interconnected bodies corporate and other persons identified at paragraph 5 and its/their existing competitors in each market.

26. As noted in response to Question 1, Pedersen's core business is and has been the provision of support services to the timber industry and in particular to CHH. Pedersen and CHH are currently parties to:
- (a) a woodchip supply contract pursuant to which Pedersen supplies woodchips to CHH;
 - (b) a chipping and debarking agreement pursuant to which Pedersen supplies chipping and debarking services to CHH at its Kinleith Mill;
 - (c) an agreement pursuant to which Pedersen carries out all log yard services for CHH at CHH site at Kinleith; and
 - (d) a roundwood agreement pursuant to which Pedersen supplies CHH with roundwood and associated products.
27. These agreements have been in existence for a number of years.
[CONFIDENTIAL]

8. Do any directors of the 'acquirer' also hold directorships in any other companies which are involved in the markets in which the target company/business operates?

28. No.

9. What are the business activities of each participant?

CHH

29. CHH is a wood fibre products company and carries on business activities in wood products, pulp and paper, packaging and building supplies. It produces wood products for the same markets.

Pedersen

30. Pedersen is a wood products service group operating contracting services for market participants such as CHH and also carries on a saw milling operation.

10. What are the reasons for the proposal and the intentions in respect of the acquired or merged business?

CHH rationale

31. CHH and Pedersen have had an ongoing relationship for some time. During the period June-August 2006, representatives of CHH and Pedersen meet to discuss the ongoing relationship. Pedersen expressed a desire to be CHH's preferred supplier of log-yard services.

32. **[CONFIDENTIAL]**

] The sawn timber market in New Zealand is extremely fragmented. It is vigorously competitive – with some 28 “bigger mills” operating in the North Island in addition to a plethora of (in the order of 180) smaller sawmills – and exhibits material excess capacity.

33. **[CONFIDENTIAL]**

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34. Representatives for Pedersen informed CHH that Pedersen's core business was log-yard services by default, in that it had entered into the business at the request of CHH in order to supply CHH. When this supply arrangement was no longer required by CHH, Pedersen determined to continue and to supply others rather than to shut it down. Pedersen suggested that CHH could acquire its sawn timber business. From CHH's perspective, the acquisition of Lakesawn Lumber's sawn timber business is an opportunity to achieve increased economies of scale in its North Island sawn timber business, thereby, reducing its operating cost base and increasing the efficiency of its operations.
35. However, given the excess capacity in the market and CHH's existing position, CHH does not require all the sawn timber assets currently operated by Pedersen. Rather than have CHH acquire those assets and then on-sell them, the parties have determined the most efficient method for disposal

would be for Pedersen to dispose of those assets. Pedersen will sell those assets outside New Zealand and Australia.¹

Pedersen's rationale

36. Pedersen's core business is, and has been, the provision of support services to the timber industry and, in particular, to CHH. [CONFIDENTIAL

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37. [CONFIDENTIAL

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¹ The alternative to this arrangement would be for CHH to acquire the assets and then on-sell them outside New Zealand. In competition terms, these two outcomes are identical in substance, if not in form.

PART II: IDENTIFICATION OF MARKETS AFFECTED

Horizontal Aggregation

11. Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition?

38. The Acquisition will result in the aggregation of existing CHH's and Lakesawn Lumber's structural and industrial saw milling businesses.

Product markets

39. The Commission has previously considered the markets for sawn timber, most recently in:
- Carter Holt Harvey Limited/Tenon Limited, 21 December 2004 (**Decision 543**);
 - Fletcher Challenge Forests Limited/Central North Island Forest Partnership, 14 August 2002 (**Decision 468**); and
 - Carter Holt Harvey Limited/Central North Island Forest Partnership, 5 July 2001 (**Decision 426**).
40. In Decision 468 and Decision 426, the Commission defined a market for the production and supply of sawn timber in the North Island. In Decision 543 the Commission defined narrower North Island markets for:
- (a) the production and wholesale supply of structural timber; and
 - (b) the production and wholesale supply of industrial timber.
41. While it defined a separate industrial timber market, the Commission noted that all sawmills producing structural timber would also necessarily produce industrial timber – the latter simply being a by-product of the former. Accordingly, it considered the competition law analysis would be the same for both markets. CHH considers that analysis to be correct and, therefore, submits there is little difference between a sawn timber market and a structural timber market.
42. Because the competition law analysis of both markets is likely to be identical, this application focuses only on the structural timber market. However, the observations are equally apposite for the industrial timber segment.

Geography

43. CHH considers the structural timber market to be wider than the North Island market previously adopted by the Commission. South Island producers provide a material level of constraint. **[CONFIDENTIAL]**

44. Nevertheless, the Acquisition would not substantially lessen competition in a North Island market and, taking a conservative approach, CHH has analysed the impact of the Acquisition in this narrower North Island structural timber market (**North Island Structural Timber Market**). However, CHH places weight on the constraint imposed by suppliers from the South Island and their ability to competitively expand supply.

Differentiated Product Markets

12. Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).

45. Structural timber is a commodity. Nevertheless, in Decision 543, the Commission did consider whether to define separate Machine Stress Graded (**MSG**) and Visually Stress Graded (**VSG**) structural timber markets but determined not to because:
- (a) a new amended standard (NZS3622) was to be introduced that would accord the same engineering properties to both MSG and VSG structural timber; and
 - (b) customers would treat MSG and VSG structural timber as interchangeable after the standard was introduced.
46. The new amended standard has been notified and comes into effect on 1 April 2007. Accordingly, the Commission's conclusion that there are not separate markets for VSG and MSG timber remains appropriate.

13. For differentiated product markets

13.1 Please indicate the principle characteristics of products that cause them to be differentiated one from another.

47. Not applicable.

13.2 To what extent does product differentiation lead firms to tailor and market their products to particular buyer groups or market niches?

48. Not applicable.

13.3 Of the various products in the market, which are close substitutes for the products of the proposed combined entity and which are more distant substitutes?

49. Not applicable.

13.4 Given the level of product differentiation, to what extent do you consider that the merged entity would be constrained in its actions by the presence of other suppliers in the affected market(s)?

50. Not applicable.

Vertical Integration

14. Will the proposal result in vertical integration between firms involved at different functional levels?

51. The Acquisition will not result in any materially increased vertical aggregation.

15. In respect of each market identified in questions 11 and/or 14 identify briefly:

15.1 All proposed acquisitions of assets of a business or shares involving either participant (or any interconnected body corporate thereof) notified to the Commission in the last three years.

52. CHH has notified the Commission concerning the following sawmilling acquisitions:

- (a) its acquisition of the structural and wood processing business and assets of Tenon Limited; and
- (b) its acquisition of TDC Sawmills Limited.

15.2 Any other acquisition of assets of a business or shares which either participant (or any interconnected body corporate) has undertaken in the last three years.

53. CHH has undertaken no other sawmilling acquisitions in addition to those highlighted in question 15.1(a) and (c). CHH can provide information on acquisitions in other areas of its business if the Commission requires that information.

PART III: CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

Existing Competitors

16. In the market or markets, who are the suppliers of competing products, including imports?

54. As the Commission noted when clearing CHH to acquire Tenon:

...all industry participants interviewed by the Commission, including building supply chains, considered that competition in the market for structural timber is vigorous and would be likely to remain so post-acquisition. Presently, building supply chains purchase their structural timber from a number of suppliers, including some of the smaller operators. The building supply chains were of the view that post-acquisition, the combined entity would continue to be constrained on price and quality by the other market.²

55. The Commission's conclusions have been reinforced by market evidence since 2003.

56. The North Island Structural Timber Market is extremely fragmented with over 200 sawmills present in the market. Following the Acquisition, CHH estimates it will have a North Island market share of [CONFIDENTIAL]%. The next largest competitor in the market will be Red Stag which CHH estimates has a market share of [CONFIDENTIAL]%. Red Stag has grown this share since its entry only three years ago. Red Stag has also just announced a plan to increase the log-in production capacity of its Rotorua mill from 300,000m³ to 450,000m³ per year. In announcing the expansion, Red Stag's CEO stated Red Stag would continue to prioritise domestic sales, which would account for approximately 55% of sales. A copy of Red Stag's press release announcing this expansion is attached as **Annexure 1**.

57. The other larger competitors in the market are listed in Table 1.

58. Figure 1 below demonstrates that nominal prices remained relatively static over the period from January 2004 to July 2006 at which time prices dropped materially. This drop in price reflected the usual fall in prices in winter months reflecting lower demand exacerbated by expectations of a declining housing market. That expectation drove market participants to offer lower prices to drive volume.

[CONFIDENTIAL]

² Decision 543, paragraph 132.

59. While nominal prices have not increased, there have been increasing costs generally in the market. Between September 2004 and September 2006, inflation was 7% and over the last two years CHH has experienced a material increase in its wood products operating costs. For example:

- (a) Log prices – which account for [CONFIDENTIAL]% of the cost of structural timber: Log prices increased by [CONFIDENTIAL]% in the 12 months to 30 June 2006 as compared to the 12 months to 30 June 2005 and are budgeted to increase by a further [CONFIDENTIAL]% in the 12 months to 30 June 2007. In fact, CHH now expects log prices to increase by around [CONFIDENTIAL]% in the 12 months to 30 June 2007. The budgeted increase represents a total increase in costs due to cost price increases (i.e., excluding cost increases due to volume increases) of NZ\$[CONFIDENTIAL] or [CONFIDENTIAL]% over two years.
- (b) Labour costs: Direct employee costs increased by [CONFIDENTIAL]% in the 12 months to 30 June 2006 as compared to the 12 months to 30 June 2005 and are budgeted to increase by a further [CONFIDENTIAL]% in the 12 months to 30 June 2007. This represents a total increase in costs of NZ\$[CONFIDENTIAL]m due to cost price increases (i.e., excluding cost increases due to volume increases) or [CONFIDENTIAL]% over two years.
- (c) Energy: Energy costs increased by [CONFIDENTIAL]% in the 12 months to 30 June 2006 as compared to the 12 months to 30 June 2005 and are budgeted to increase by a further [CONFIDENTIAL]% in the 12 months to 30 June 2007. This represents a total increase in costs due to cost price increases (i.e., excluding cost increases due to volume increases) of NZ\$[CONFIDENTIAL]m or [CONFIDENTIAL]% over two years.
- (d) Freight: Local freight costs increased by [CONFIDENTIAL]% in the 12 months to 30 June 2006 as compared to the 12 months to 30 June 2005 and are budgeted to increase by a further [CONFIDENTIAL]% in the 12 months to 30 June 2007. This represents a total increase in costs due to cost price increases (i.e., excluding cost increases due to volume increases) of NZ\$[CONFIDENTIAL]m or [CONFIDENTIAL]% over two years.
- (e) Chemicals: Inks and chemicals consumed decreased by [CONFIDENTIAL]% in the 12 months to 30 June 2006 as compared to the 12 months to 30 June 2005 and are budgeted to increase by [CONFIDENTIAL]% in the 12 months to 30 June 2007. This represents a total increase in costs due to price increases (i.e., excluding cost increases due to volume increases) of NZ\$[CONFIDENTIAL]m over two years.

17. Conditions of expansion and entry

60. There are no significant barriers to expansion (or to entry) in the North Island Structural Timber Market. This was implicitly accepted by the Commission in Decision 543 when it concluded it was:

...satisfied that post-acquisition, the combined entity is likely to be constrained by existing competition from other market participants producing both MSG and VSG timber, such that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the structural timber market.³

61. Nothing has changed in today's market to suggest the Commission should revisit this conclusion. Indeed, the lack of barriers to entry and expansion is evidenced by the recent and continuing expansion of Red Stag (discussed below) which has commenced structural timber operations within the last three years and has quickly established a significant market share and continues to plan and implement expansions.

Current excess capacity

62. There is currently material excess capacity in the North Island. Confidential Table 1 illustrates this taking into account only the larger North Island mills and not:

- (a) the supply from the plethora of other sawmills in the North Island;
- (b) structural timber imported from the South Island; or
- (c) structural timber imported from outside New Zealand.

Table 1: Current competitors by region

Region	Sawmill	Estimated Current Structural Production	Estimated Structural Production Capacity
Northland (Demand ≈ [CONFIDENTIAL])	<ul style="list-style-type: none"> ▪ CHH⁴ ▪ Northpine ▪ Rosevalls 	[CONFIDENTIAL]	[CONFIDENTIAL]
Auckland (Demand ≈ [CONFIDENTIAL])	<ul style="list-style-type: none"> ▪ Ahead Lumber ▪ Pinepac 	[CONFIDENTIAL]	[CONFIDENTIAL]
CNI (Demand ≈ [CONFIDENTIAL])	<ul style="list-style-type: none"> ▪ CHH ▪ Lakesawn ▪ Red Stag 	[CONFIDENTIAL]	[CONFIDENTIAL]

³ Decision 543, paragraph 140.

⁴ Includes TDC Sawmills Limited.

Region	Sawmill	Estimated Current Structural Production	Estimated Structural Production Capacity
	<ul style="list-style-type: none"> WPI Donnelly Kiwi Lumber 	[CONFIDENTIAL]	[CONFIDENTIAL]
East Coast (Demand [CONFIDENTIAL]) ≈	<ul style="list-style-type: none"> Pan Pac Prime 	[CONFIDENTIAL]	[CONFIDENTIAL]
Lower/West North Island (Demand [CONFIDENTIAL]) ≈	<ul style="list-style-type: none"> Eurocell Taranaki Sawmills Allied Pine 	[CONFIDENTIAL]	[CONFIDENTIAL]

63. Table 1 demonstrates that there is enough existing non-CHH capacity (excluding Lakesawn Lumber's current capacity) in the North Island to supply [CONFIDENTIAL]% of North Island demand. This will increase to [CONFIDENTIAL]% when Red Stag completes its expansion programme. Any of the participants with spare capacity could increase production immediately.

Evidence of recent expansion

64. The costs of expansion are not substantial. This is evidenced by the recent and continuing expansion of Red Stag. Red Stag commenced operations within the last three years and has quickly established a significant market share. There are no signs Red Stag intends to slow its growth rate.
65. On the contrary on 23 November 2006 Red Stag announced a further expansion of its Rotorua mill plus the addition of a third shift lifting its log-in production capacity from 300,000m³ to 450,000m³ per year. This comes on top of an increase of 50% from 200,000m³ to 300,000m³ per year, which commenced in October last year.

Consents and lead times

66. CHH believes that most sawmills have resource consents to produce a greater amount than those sawmills in fact produce. Where a sawmill has

existing consents, there are a number of ways in which a sawmill can increase production, including:

- (a) by adding overtime, which can happen within a week;
- (b) by adding an additional shift, which can happen within one month; or
- (c) by increasing production facilities, which can happen rapidly as demonstrated by Red Stag's recent expansion.

Access to logs

67. A sawmill must have access to sufficient high density logs in order to be able to expand. In Decision 543 some industry participants submitted following its acquisition of Tenon, CHH would "have such buyer power that it would be able to either purchase all of the available logs in the central North Island area, or bid prices up so that other sawmills could not compete for such logs".⁵
68. The Commission did not accept these submissions noting:
- (a) as a result of (then) recent forestry divestments, there were a greater number of sellers of high density logs;
 - (b) forest owners interviewed expressed their desire for a diversified customer base; and
 - (c) forest owners interviewed expressed the view CHH would be unlikely to embark on such a strategy because it would be unlikely to have sufficient capacity to process such a volume of logs.
69. CHH has recently divested virtually all of its forest assets reducing its involvement and influence in this area. Furthermore, the domestic log market is very competitive and the domestic log price is driven primarily by export parity meaning that CHH has virtually no ability to influence the domestic log price (as evidenced by recent log price increases). CHH does have long-term supply contracts with prices benchmarked to domestic and international prices (albeit that the domestic price is driven by the international price).

Access to distribution channels

70. During its investigation in Decision 543, the Commission received evidence that:

Presently, building supply chains purchase their structural timber from a number of suppliers, including some of the smaller operators.⁶

⁵ Decision 543, paragraph 136.

⁶ Decision 543, paragraph 132.

71. This remains the case today and access to distribution channels is not a barrier to expansion particularly if CHH sought to increase prices to supra-competitive levels.

18 Please name any business which already supplies the market - including overseas firms - which you consider could increase supply of the product concerned in the geographic market by any of the following means:

- diverting production into the market (e.g., from exports)
 - increasing utilisation of existing capacity
 - expansion of existing capacity.
-

72. All of the companies listed in Confidential Table 1. In particular, Red Stag has shown an increase in this market.

19. Of the conditions of expansion listed above, which do you consider would influence the business decision in each case to increase supply?

73. The material excess capacity in the market is likely to influence expansion decisions. Provided the price of Structural Timber exceeds the operating costs associated with log supply prices, there will be an incentive for participants to increase production so as to spread fixed and overhead costs over a larger production base.

20. How long would you expect it to take for supply to increase in each case?

74. Given the existence of excess capacity, participants could increase supply very rapidly, within a period of weeks.

21. In your opinion, to what extent would the possible competitive response of existing suppliers constrain the merged entity?

75. As there are no material barriers to expansion, the threat of expansion by existing competitors currently maintains prices at competitive levels. The Acquisition will not raise barriers to expansion. **[CONFIDENTIAL**

]. Accordingly, the threat of expansion will continue to maintain prices at competitive levels post-Acquisition.

22. Looked at overall, and bearing in mind the increase in market concentration that would be brought about by the acquisition, to what extent do you consider that the merged entity would be constrained in its actions by the conduct of existing competitors in the markets affected?

76. CHH considers that nothing has changed in the market to cause the Commission to revisit its conclusion in Decision 543 that:

...post-acquisition, the combined entity is likely to be constrained by existing competition from other market participants producing both MSG and VSG timber, such that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the structural timber market.

Coordinated Market Power

23. Identify the various characteristics of the market that, post-acquisition, you consider would either facilitate or impede coordination effects.

77. The Commission did not consider it necessary to assess whether CHH's acquisition of Tenon would increase the likelihood of coordinated market power. CHH considers this appropriate given the extremely fragmented nature of the market (both on the demand and the supply side). Given Pedersen does not act as a maverick in this market, like the CHH/Tenon acquisition, the Acquisition cannot be considered to enhance the likelihood of the exercise of co-ordinated market power.

24. Identify the various characteristics of the market that, post-acquisition, you consider would facilitate or impede the monitoring and enforcement of coordinated behaviour by market participants.

78. There are a number of factors which impede, and which will continue to impede, coordinated conduct in this market post-Acquisition including:

- (a) The extremely fragmented nature of the market;
- (b) Reasonably robust growth;
- (c) Lack of price transparency; and
- (d) The differing cost structures of market participants (which was noted by the Commission in Decision 426⁷).

⁷ Decision 426, paragraph 188.

25. Indicate whether the markets identified in paragraph 9 above show any evidence of price coordination, price matching or price following by market participants.

79. There is no evidence of anti-competitive price coordination or leader/follower behaviour in this market.

26. Please state the reasons why, in your opinion, the transaction will not increase the risk of coordinated behaviour in the relevant market(s).

80. The highly fragmented nature of the market coupled with the existence of excess production capacity capable of being deployed at low marginal costs undermines any incentive for firms in the market to coordinate their conduct. The Acquisition does not materially change any of the factors leading to this outcome.

PART IV: CONSTRAINTS ON MARKET POWER BY POTENTIAL COMPETITION

Conditions of Entry

27. Which, if any, of the following conditions do you consider would be likely to act as a barrier to the entry of new competitors, where they otherwise would have the incentive to do so in response to a sustained effort by the combined entity to raise price, or to lower service or product quality?

81. There are no barriers or conditions of entry likely to impede new entry into the North Island Structural Timber Market. CHH considers new entry could occur in one of four ways:
- (a) Existing South Island structural timber producers expand imports into the North Island;
 - (b) Foreign producers expand supply into the North Island;
 - (c) Appearance grade producers commence supply of structural timber in the North Island; or
 - (d) *De novo* entry.
82. In Decision 426 the Commission identified that a new entrant into the sawn timber market would require capital to invest in the necessary plant and equipment, access to logs, competencies in sawmilling through the hire of skilled labour and competencies in selling and marketing. The Commission's analysis in Decision 426 was predicated on a sawn timber market. That market included appearance grade producers.
83. The conditions of entry identified by the Commission in Decision 426 are only likely to be relevant for a *de novo* entrant. Existing structural timber producers and appearance grade timber producers already have the necessary competencies and ability to source log supply in order to enter the narrower North Island Structural Timber Market.
84. In respect of capital costs, the Commission concluded that capital costs did not amount to a barrier to entry for a small to medium size entrant (NZ\$5-20m) but amounted to a moderate barrier to entry for a large entrant (up to NZ\$40m).⁸ However, existing South Island and foreign structural timber producers will not face this level of capital costs. Furthermore, appearance grade timber producers would have already incurred many of the capital costs necessary to compete. Existing appearance grade timber producers could switch to supplying structural timber with relatively little capital outlay

⁸ Decision 426, paragraph 192.

and the ease with which that can be achieved is amply demonstrated by the entry/expansion of Red Stag, TDC and others.

28. Please name any businesses (including overseas businesses) which do not currently supply the market but which you consider could supply the relevant market(s) by:

- investing in new production facilities to produce the product;
- overseas companies diverting production to New Zealand;
- domestic companies expanding, or changing the utilisation of, existing capacity to produce the relevant products (where this would involve substantial new investment)

South Island producers

85. South Island structural timber is already being supplied into the North Island
[CONFIDENTIAL]

] Like the North Island, there is excess production capacity in the South Island, which could be deployed to produce structural timber for the North Island. The current South Island market participants are set out in Table 2.

Table 2: Potential entrants – South Island structural wood producers

Sawmill	Location	Current Structural Production	Structural capacity (m ³)
Blue Mountain Lumber (E1)	Otago	[CONFIDENTIAL]	[CONFIDENTIAL]
Flights	Blenheim	[CONFIDENTIAL]	[CONFIDENTIAL]
McAlpines	Christchurch	[CONFIDENTIAL]	[CONFIDENTIAL]
Moutere Timber	Nelson	[CONFIDENTIAL]	[CONFIDENTIAL]
Southpine	Nelson	[CONFIDENTIAL]	[CONFIDENTIAL]
Waimea	Nelson	[CONFIDENTIAL]	[CONFIDENTIAL]

Source: CHH

Foreign producers

86. There are no barriers to entry for an Australian producer (in particular) wishing to import structural timber into New Zealand. New Zealand and Australian building standards are the same. However, when New Zealand's new building standards are adopted (expected to be 1 April 2007),

Australian mills will have to slightly adjust their production processes to produce New Zealand specific structural timber. Given the excess supply situation in the South Eastern Australian market (Victoria and South Australia), such activity could still occur.

87. There are already some limited volumes of structural timber supplied into the North Island Structural Timber Market. CHH understands:
- (a) Hyne Timber, a Queensland based wood products company with operations extending throughout eastern Australia from Cairns in far North Queensland to Melbourne in Victoria, has previously supplied structural timber into the New Zealand market from its Australia sawmills.
[CONFIDENTIAL]
 - (b) Stora Enso – a European producer – has been importing and selling product in Auckland. Stora Enso has a large market share in the Australian market and could expand further in New Zealand.

88. The threat of imports from Australia impacts on CHH's pricing decisions.

Appearance grade producers

89. Appearance grade sawmills can be converted to producing structural grade timber with relative ease. The capital costs of installing the necessary equipment would be in the order of \$[CONFIDENTIAL]. Given the existence of an active global second hand market for sawmilling equipment, this \$[CONFIDENTIAL] does not represent a sunk cost.
90. Switching by appearance grade producers occurred in 2002-2003 as a downturn in the United States appearance market drove a number of New Zealand producers to convert to a New Zealand structural cut. With the decrease in market prices in the United States driven by Chilean imports, and the appreciation of the NZD against the USD beginning in late 2002 and intensifying in 2003, New Zealand exporters began to redirect product into the domestic market. For some this meant changing the cut in their mill to a structural cut and placing product into the local market. TDC, for example, redirected its entire production of 60,000m³ to New Zealand merchants. This was achieved within a few months and the cost was minimal. Price was the main factor which enabled those firms to gain market share.
91. Potential appearance grade producers are set out in Table 3.

Table 3: Potential entrants - established sawmills in North Island

Sawmill	Region	Product	Estimated mill capacity (m ³)
Claymark	CNI	Pruned	[CONFIDENTIAL]
Mamaku	CNI	Pruned /	[CONFIDENTIAL]

Sawmill	Region	Product	Estimated mill capacity (m ³)
		Unpruned	
Matangi	CNI	Pruned	[CONFIDENTIAL]
McAlpines	CNI	Unpruned	[CONFIDENTIAL]
Pacific Pine	CNI	Pruned / Unpruned	[CONFIDENTIAL]
Puke Pine	CNI	Pruned / Unpruned	[CONFIDENTIAL]
Rotorua Sawmills	CNI	Pruned / Unpruned	[CONFIDENTIAL]
Tachikawa	CNI	Unpruned	[CONFIDENTIAL]
Tenon	CNI	Pruned / Unpruned	[CONFIDENTIAL]
Thames Timber	N	Pruned	[CONFIDENTIAL]
Tuakau	N	Roundwood	[CONFIDENTIAL]
Tregoweths	CNI	Pruned / Unpruned	[CONFIDENTIAL]
Vanners	CNI	Unpruned	[CONFIDENTIAL]
Waitete	CNI	Pruned	[CONFIDENTIAL]

Source: CHH

29. What conditions of entry do you consider would most influence the business decisions to enter in each case?

92. In the absence of any material conditions of entry, CHH considers that price will be the ultimate determinant of new entry. If prices increased to supra-competitive levels, then new entry in any one or more of the ways listed above would be likely to occur very rapidly.

Likelihood, Sufficiency and Timeliness of Entry

30. How long would you expect it to take for entry to occur, and for market supply to increase, in respect of each of the potential business entrants named above?

93. If prices increased to supra-competitive levels, new entry in any one or more of the ways listed above would be likely to occur very rapidly and certainly

within the three year period identified by the High Court in *Commerce Commission v New Zealand Bus Limited* (Unreported, High Court, Wellington, CIV 2006-485-585, 29 June 2006). The entry and expansion of Red Stag over a three year period since 2003 is evidence of the ease and speed with which constraining entry can occur. The Acquisition in no way creates or extends a barrier to entry or expansion for any of the existing structural or appearance grade saw mills. Machinery and raw materials (logs) are readily available and not in any way controlled by CHH. Acquirers are for the most part major groups having countervailing power and with the power to promote or support suppliers. They have a history of doing so, regardless of size of the supplier.

31. Given the assessed entry conditions, and the costs that these might impose upon an entrant, is it likely that a potential entrant would consider entry profitable at pre-acquisition prices?

94. Again, the entry and continued expansion of Red Stag, the entry of South Island producers and foreign producers suggests that a new entrant would find entry profitable at pre-acquisition prices.

32. Would the threat of entry be at a level and spread of sales that it is likely to cause market participants to react in a significant manner?

95. Because customers acquire from both large and small producers, CHH faces constraint from a range of suppliers. Accordingly, any entry will add to the constraint currently felt by CHH.

33. What conditions of entry do you consider would influence the business decision to enter the market by setting up from scratch, i.e. *de novo* entry?

96. Price would be the most important factor in a decision to enter. If prices increased to supra-competitive levels, a new entrant could enter particularly if sponsored by an existing retail supplier (e.g., an ITM branch).

34. How long would you expect it to take for *de novo* entry to occur?

97. *De novo* entry could occur within 18-24 months.

35. In your opinion, to what extent would the possibility of *de novo* entry constrain the merged entity?

98. CHH considers that *de novo* entry is less likely than entry by South Island structural timber producers, foreign structural timber producers and appearance grade timber producers.

PART V: OTHER POTENTIAL CONSTRAINTS

Constraints on Market Power by the Conduct of Suppliers

36. Who would be the suppliers of goods or services to the merged entity in each market identified in questions 11 and/or 14?

99. The major suppliers of the merged entity would be the current owners of forestry estates in the Central North Island, namely:
- (a) Hancock Natural Resource Group, Inc;
 - (b) Kaingaroa Timberlands Limited, an entity controlled by the non-profit Harvard Management Company, part of the endowment fund of Harvard University;
 - (c) Matariki Forestry Group, which is ultimately owned by Rayonier Inc and RREEF Infrastructure Investments, the global infrastructure arm of Deutsche Asset Management;
 - (d) Lake Taupo Forests, owned and managed by the Ministry of Forestry; and
 - (e) GMO Renewable Resources Ltd.

37. Who owns them?

100. See response to Question 36.

38. In your opinion, to what extent would the conduct of suppliers of goods or services to the merged entity constrain the merged entity in each relevant market?

101. Log supply accounts for a substantial proportion of the costs of producing structural timber.

Constraints on Market Power by the Conduct of Acquirers

39. Who would be the acquirers of goods or services supplied by the merged entity in each of the markets identified in questions 11 and/or 14?

102. Structural timber is wholesaled to retail building supply chains who in turn distribute to end users being either consumers or builders. The five major building supply chains are set out below together with their share of the retail market:
- (a) PlaceMakers [CONFIDENTIAL];
 - (b) Carters [CONFIDENTIAL];

- (c) ITM [CONFIDENTIAL];
- (d) Bunnings [CONFIDENTIAL]; and
- (e) Mitre 10 [CONFIDENTIAL].

103. A list of CHH's largest 10 customers by region is included as **Confidential Annexure 2**.

40. Who owns them (where appropriate)?

104. The ownership structure of the retail supply chains is set out below:

- (a) PlaceMakers is the trading name of Fletcher Distribution Limited, the retail trading arm of Fletcher Building Limited in New Zealand. Each PlaceMakers store is a joint venture between a local business partner and Fletcher Distribution Limited.
- (b) Carters is ultimately owned by CHH.
- (c) ITM is a cooperative buying group comprising 80 stores throughout New Zealand. Each store is locally owned and operated and supported by a national Support Office.
- (d) Bunnings is the largest building supplies retailer in Australasia. It is ultimately owned by Australian company Wesfarmers.
- (e) Mitre10 stores are locally owned and operated franchises. CHH understands the master franchise is owned by Mitre 10 (New Zealand) Limited.

41. In your opinion to what extent would the conduct of acquirers of goods or services to the merged entity constrain the merged entity in each affected market? How would this happen?

105. In Decision 426, the Commission noted that the large independent distribution channels would be able to exert a degree of countervailing power over CHH.⁹ CHH agrees; building supply chains continue to exert significant countervailing power given the large proportion of the retail market they account for, which (excluding Carters) is [CONFIDENTIAL]%.

106. In addition, in Decision 543, the Commission noted it had received evidence that:

Presently, building supply chains purchase their structural timber from a number of suppliers, including some of the smaller operators.¹⁰

⁹ Decision 426, paragraph 194.

¹⁰ Decision 543, paragraph 132.

107. Building merchants continue to purchase locally in today's market from smaller mills as well as larger mills and CHH expects this to continue particularly when the new amended VSG standard becomes effective. When coupled with the presence of excess capacity in the North Island, building supply chains have material countervailing power.
108. In the case of larger jobs, merchants are actively competing to obtain business by tender. As a result, these merchants approach a number of producers in an attempt to source low cost product. If CHH were to price above competitive levels, the merchant would simply acquire timber from another producer.
109. Customers routinely approach CHH in order to seek to obtain a better price based on a competitive offering. **[CONFIDENTIAL]**

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110. This process is indicative of the way in which competition in this market occurs although CHH seeks to price competitively initially to avoid churning customers.
111. The ability for merchants to exercise countervailing power by changing between suppliers can be seen in **[CONFIDENTIAL]**.

THIS NOTICE is given by:

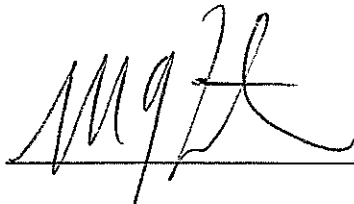
Carter Holt Harvey Limited

The company hereby confirms that:

- * all information specified by the Commission has been supplied;
- * all information known to the applicant/s which is relevant to the consideration of this application/notice has been supplied;
- * all information supplied is correct as at the date of this application/notice.

The company undertakes to advise the Commission immediately of any material change in circumstances relating to the application/notice.

Dated this 17th day of January 2007.

A handwritten signature in black ink, appearing to read 'M Falconer', is written over a horizontal line.

Michael Falconer
Chief Executive Officer
Carter Holt Harvey Wood Products

I am an officer of the company and am duly authorised to make this application/notice.



Red Stag Timber Limited
Waipa Mill, P O Box 1748, Rotorua, New Zealand
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MEDIA RELEASE – for immediate use

Thursday, 23 November 2006

RED STAG TIMBER PLANS FURTHER EXPANSION

Red Stag Timber, which operates Waipa Mill, Rotorua, New Zealand's largest sawmill and timber processing plant, today announced plans for a further wave of expansion of the mill's production capacity, which will also provide an additional boost to the Rotorua economy.

This further expansion will lift production to 330,000m³ on two shifts, and to 450,000m³ when a third shift is added. It comes in the wake of the company's recent 50% expansion of production capacity, from 200,000m³ to 300,000m³ on two shifts, by its new planer mill and additional kiln that were officially opened on 4 October 2006 by Prime Minister Helen Clark.

Phil Verry, executive chairman of Red Stag Timber, said the company's board met yesterday and approved four new projects with a capital cost of \$2.5 million that will improve the mill's efficiency and hourly production. The board also instigated a study to add a third shift. Further expansion projects, some major, are also under study.

"The changed landscape of the industry and our staff's commitment to quality and service are generating strong domestic demand for Red Stag's structural timber, as existing and new customers realise the strategic importance to their businesses of having two volume suppliers with national distribution. At present, we are unable to satisfy all of the increasing demand, so our decisions to expand production are soundly based. They are also consistent with our low-debt low-risk policy", says Phil Verry.

He says the company is maintaining its policy of prioritising the domestic structural timber market. It will continue to sell around 55% of its total production domestically and 45% to export.

"We have the resources to further expand export production but, while the Reserve Bank continues its attack on exporters' prices and incomes with its artificially high NZ dollar policy, to accommodate increases to incomes and prices in the non-tradables sector including a 5% pay increase to the Bank's own staff, such investment would be imprudent", says Phil Verry.

"Those naive souls who tell NZ exporters that they should get used to the high NZ dollar should understand that, in fact, NZ exporters and potential exporters have already done that. They are not investing for export"

"That is why, relatively, export revenues have shrunk and the annual current account deficit of over \$15 billion is the world's highest per capita. The deficits are now unsustainably massive, but are becoming chronic. They are forcing the country to finance its declining relative incomes by mortgaging its future with foreign debt, now more than \$150 billion, also the world's highest per capita," Verry says.

Phil Verry, who returned on Sunday from a trade mission to China, warns that New Zealand policymakers should not expect significant export gains if a free trade agreement with China is negotiated.

"The high NZ dollar policy operated by the Reserve Bank of NZ is in effect a tariff on all New Zealand exports. Under present Reserve Bank policy, this tariff on exports is likely to increase if China reduces its tariffs. So, we have the irony of certain NZ government officials trying to persuade China to reduce tariffs while Reserve Bank officials cancel out their efforts by erecting a defacto export tariff barrier that is even more economically destructive, because it damages to all NZ exporters and deters potential exporters", Phil Verry says.

"The Reserve Bank of NZ should study why China operates a low exchange rate policy, which is enabling it to colonise many of the world's manufacturing industries and financial markets by its resulting massive current account surpluses. China, sensibly, chooses a predatory exchange rate, so has massive growth. New Zealand, foolishly, chooses a prey exchange rate policy, so is failing".

Phil Verry says the Reserve Bank's high interest, high NZ dollar policy is both derisory and unnecessary and that, while it continues, New Zealanders should get used to declining relative incomes and to the prospect of facing a future economic crisis when foreign lenders pull out, which may not be far off.

END

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Confidential Annexure 2