



COMMERCE COMMISSION

Decision No. 587

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

GODFREY HIRST NZ LIMITED

and

FELTEX CARPETS LIMITED

The Commission: Paula Rebstock
David Caygill
Denese Bates QC

Summary of Application: The acquisition by Godfrey Hirst NZ Limited of some or all of the assets of Feltex Carpets Limited.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.

Date of Determination: 31 August 2006

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EXECUTIVE SUMMARY

1. The Commission has considered the likely nature and extent of competition that would exist, subsequent to the proposed acquisition, in following markets:
 - the North Island market for the supply of wool scouring services (North Island scouring market); and
 - the national market for the manufacture/import and wholesale supply of carpet (national carpet market).
2. The Commission considers that the relevant counterfactual is the purchase of Feltex by an independent third party, being an entity that does not currently have a presence in the carpet manufacturing industry.
3. In the North Island scouring market, the Commission considers that due to the level of existing competition in the market and the level of excess capacity held by wool scourers, the proposal is unlikely to result in a substantial lessening of competition.
4. In the national carpet market, the Commission considers that given the presence of alternative established carpet manufacturers, the presence of some excess capacity, the ease of importing carpet and a degree of countervailing power held by retailers of carpet, the proposed acquisition is unlikely to result in a substantial lessening of competition.
5. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 2 August 2006. The notice sought clearance by Godfrey Hirst NZ Limited (Godfrey Hirst or the Applicant) to acquire all or some of the assets of Feltex Carpets Limited (Feltex).

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to give a clearance or to decline to give a clearance for the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the application was required by 31 August 2006.
3. The Applicant sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal would have the effect of substantially lessening competition, or would be likely to have the effect of substantially lessening competition, in any market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance, has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³
7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.⁴ Competition must be lessened in a considerable and sustainable way.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, (unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier), Para 42.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any give case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:
 - Existing competition;
 - Potential competition; and
 - Other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Godfrey Hirst

12. Godfrey Hirst is ultimately owned by the McKendrick family (and their related interests) who also own Godfrey Hirst (Australia) Pty Limited. Both companies are vertically integrated manufacturers of synthetic and woollen tufted carpets, in New Zealand and Australia.
13. Godfrey Hirst is the sole shareholder in Clifton Wool Scour Limited (CWS), situated in Hawkes Bay, and holds 99.99% of the shares in Canterbury Spinners Limited, located in the North and South Islands respectively.

Feltex

14. Feltex is a vertically integrated manufacturer of carpets in New Zealand and Australia.

15. Feltex owns and operates a wool scouring plant in the Manawatu and four yarn spinning plants throughout the country.
16. Feltex is the only New Zealand manufacturer of woven carpet, which it produces in Christchurch; it also produces a range of woollen tufted carpets in New Zealand and synthetic carpets in Australia.

OTHER PARTIES

Cavalier Bremworth Limited (Cavalier)

17. Cavalier Bremworth is a New Zealand based manufacturer of woollen and tufted carpet. It has a 92.5% ownership interest in Hawkes Bay Woolscourers Limited, which owns and operates a wool scour in Napier. Cavalier Bremworth also owns its own yarn spinning plant.
18. Cavalier Bremworth manufactures a premium carpet, the Bremworth Collection, as well as the Cavalier Bremworth range. It is also the sole shareholder in Knightsbridge Carpets Limited, which manufactures a range of synthetic carpets.

Norman Ellison Carpets Limited (Norman Ellison)

19. Norman Ellison is a carpet manufacturer with tufting machinery and a yarn spinning plant located in Auckland. However, it does not own or have an ownership interest in a wool scouring plant.
20. Norman Ellison manufactures a range of synthetic and woollen tufted carpets.

Summit Wool Spinners Limited (Summit)

21. Summit is an independent spinner of yarn and has no other presence in the carpet manufacturing industry. Summit is 100% owned by the Japanese Sumitomo Corporation and is based in Oamaru.

New Zealand Wool Services International Limited (NZWS)

22. NZWS is an exporter of scoured wool and is not involved in the carpet manufacturing industry. It has an ownership interest in two wool scours including 65% ownership interest in Whakatu Wool Scour Limited, situated in Hawkes Bay.
23. At both its scours, NZWS undertakes commission based scouring for other exporters and for Norman Ellison.

INDUSTRY BACKGROUND

Wool scouring

24. Wool scouring is the process of washing wool in hot water and detergent to remove grease and dirt and then drying it. After washing and drying, the scoured wool is repackaged for further transport and processing.
25. In New Zealand, three of the four large carpet manufacturers have ownership interests in wool scouring plants. They also perform scouring on a contract basis for wool exporters and other industry participants.

Yarn Spinning

26. Scoured wool is sent to a spinning plant to be spun into yarn. Separate fibres are twisted together to bind them into a strong, long yarn. Most carpet

manufacturers, particularly the larger ones, have their own yarn spinning equipment.

Carpet manufacture

27. Carpet is manufactured using wool, wool/synthetic blends, or synthetic yarns using either a tufting or weaving process.
28. Tufted carpet is made by inserting strands of yarn into a woven or non-woven backing using a needling technique, forming loops of tufts at the required length. A latex coating is applied to the reverse side, anchoring tufts in position. A secondary backing is used in the finishing process to add strength and stability. Tufting machines produce many more metres of carpet per hour than weaving machines, and sit in the low to medium end of the market.
29. Woven carpet is produced on a loom similar to woven cloth. Typically, many coloured yarns are used and this process is capable of producing intricate patterns from pre-determined designs. These carpets tend to sit at the higher end of the market and are very labour intensive to make.

Synthetic and woollen yarns

30. Wool has excellent durability, can be dyed easily and is fairly abundant. When blended with synthetic fibres such as nylon, the durability of wool is increased. Wool yarn can be mixed with a synthetic yarn to produce what is referred to as a 'wool blend' carpet.
31. Nylon is the most popular synthetic fibre used in carpet production. Nylon can be dyed or printed easily and has excellent wear characteristics. In carpets, nylon tends to stain easily, therefore a stain repellent finish is sometimes applied.
32. Polypropylene is used to produce carpet yarns mainly because of economy. Polypropylene is difficult to dye and does not wear as well as wool or nylon.

Carpet sales and installation

33. Carpet is usually sold through retailers who also provide an installation service. Retailers commonly operate through buying groups which negotiate national supply terms and conditions with manufacturers.

MARKET DEFINITION

34. The Act defines a market as:

“... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.”⁵
35. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

⁵ Section 3(1) of the Commerce Act 1986.

Product Market

36. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.
37. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
38. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.
39. The Applicant submitted that the acquisition would result in aggregation in the markets for wool scouring and the supply of carpet. Specifically the Applicant submitted that the relevant markets are the following:
 - wool scouring services in the North Island; and
 - the supply of carpets in New Zealand.

Wool Scouring

40. Wool scouring is a specific service required to clean wool in advance of further processing. There is no demand-side substitutability for the service and similarly there is no supply-side substitutability in the provision of such services.
41. The Commission considers that it is appropriate to define a discrete market for wool scouring services.

Yarn Spinning

42. Godfrey Hirst and Feltex both have yarn spinning equipment, as do all of the larger carpet manufacturers in New Zealand. Industry participants informed the Commission that yarn spinning is undertaken as a step in the carpet manufacturing process and that carpet manufacturers do not spin yarn for anyone else. Accordingly, the Commission considers that, for the purposes of assessing the competitive effects of the proposed acquisition, yarn spinning can be assessed as a vertically integrated component of the carpet manufacturing process, rather than requiring separate analysis.

Carpet manufacturing

43. The Applicant submitted that there is some degree of demand-side substitutability between carpet and other floor coverings such as vinyl or polished wooden floors.
44. [] informed the Commission that in most cases the choice of floor covering will be determined by factors other than price. For instance most people opt for tiles or vinyl in a bathroom and kitchen setting due to the fact they can be cleaned easily.
45. The Commission considers that a SSNIP, imposed by a hypothetical monopolist supplier of carpet, would be profitable as most consumers, rather than substitute carpet for another floor covering, would be likely to switch to a slightly lower quality carpet. This suggests that it may be appropriate to limit the extent of the product market to carpet rather than including alternative floor coverings.

46. The Commission also considered whether it would be appropriate to disaggregate a carpet product market further to identify the input material, method of manufacture or product quality or whether it would be more appropriate to define a single differentiated product market.
47. Differentiated product markets are those in which the product offerings of suppliers vary to some degree and in which buyers make their purchase decision on the basis of product characteristics as well as price. In such a market, suppliers' products are imperfect substitutes for one another and less close substitutes impose a lesser competitive constraint than others.
48. As discussed in the industry background section, carpet is made from wool yarn, synthetic yarn or a blend of the two. Woollen carpets and synthetic carpets have slightly different comfort and wear characteristics that make them suitable for particular applications. For instance, synthetic carpets are cheaper and are considered to be harder wearing. As such, they are well suited to commercial applications such as office space floor coverings.
49. Woollen carpets are considered to be slightly more luxurious and better suited to residential applications.
50. In other circumstances a consumer will choose a carpet product on appearance, colour or other aesthetic qualities. [] informed the Commission that there is no single overriding consideration that is common to a consumer's choice and that typically the consumer will weigh all factors in forming a view on what is most suited to his or her needs and budget.
51. The distinction between woven and tufted carpets appears to be more evident. The Applicant informed the Commission that woven carpet is much more expensive than tufted carpet, as woven carpet manufacturing is far more labour intensive. Whilst tufted carpets are sold for a wide range of end use applications, woven carpets have more specialist applications. For instance, airlines typically opt for woven carpets in their aircraft as they contain less yarn (per lineal metre) than tufted carpets but still retain comparable wear characteristics.
52. The Commission considers that, for the purposes of assessing the proposed acquisition, it is not necessary to conclude whether woven and tufted carpets fall within the same product market. No aggregation in woven carpet will occur as a result of the acquisition as Feltex is the only New Zealand manufacturer currently producing woven carpet. As such, a broad product dimension encompassing both woven and tufted carpets is the conservative market definition.
53. The Commission also considered whether it was appropriate to draw any distinction between carpets of varying qualities. For instance a consumer wanting a high end (\$250 per lineal metre) carpet would be unlikely to consider a much cheaper (\$30 per lineal metre) carpet to be a substitute. However, it is likely that these consumers would have a range of carpets and prices within which they would be willing to switch.
54. [] informed the Commission that there is a wide range of carpet products and prices and that there are many carpet options along the spectrum from low to high end. As such, there is no distinct price or quality jump within the spectrum of carpet options. Accordingly, the Commission considers that consumers will have overlapping substitute 'bands' such that it is appropriate to define a single differentiated product market.

55. The Commission concludes that it is appropriate to define a discrete market for carpet, but that it is not necessary to further disaggregate the market to specify different input materials, methods of manufacturing or end-product quality. Instead, the Commission considers that all carpets fall within a single differentiated product market.

Conclusion on Product Markets

56. The Commission concludes that, for the purposes of assessing the competitive effect of the proposed acquisition, the relevant product markets are the markets for:
- wool scouring, and
 - carpet.

Functional Markets

Wool Scouring

57. Wool scouring services are typically provided on a commission basis. Ownership of the wool is retained by the end user, who pays a fee for the wool to be scoured and in some cases delivered to the next destination.
58. The Commission considers that the appropriate functional dimension of the wool scouring market is the supply of wool scouring services.

Carpet

59. In respect of carpet, aggregation will occur at the manufacturing and wholesale supply level. Carpet manufacturers generally do not sell products directly to consumers, but supply through a retailer (who bundles the product with an installation service).
60. Industry participants informed the Commission that carpet can be easily imported and supplied competitively within the New Zealand market. Further, New Zealand based manufacturers of carpet typically supplement ranges manufactured in New Zealand with carpet made off-shore.
61. Accordingly, the Commission considers that the appropriate functional dimension of the market is the manufacture/import and wholesale supply of carpet.

Geographic Markets

62. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

Wool Scouring services

63. The Applicant submitted that the relevant geographic market in this case is the North Island.
64. At present, very small quantities of wool are transported between the North and South Island; however, industry participants informed the Commission that this is due to the fact that there is currently no need to transport wool between the islands due to excess capacity in the wool scouring industry in both the North and South Islands.

65. Whilst it would be preferable to send wool to the nearest scour to minimise freight costs, the Commission considers that it would be feasible for wool to be sent within the island if required.
- [] informed the Commission that some wool will travel between islands, depending on the type of wool and export requirements. [] said that this was generally the exception with the vast majority of wool sourced in the North Island being scoured in the North Island and likewise in the South Island.
66. As a result of the proposed acquisition, aggregation in the supply of wool scouring services would only result in the North Island. As such the Commission considers that for the purposes of the analysis it is appropriate to define a North Island geographic market.

Carpet manufacture/import and wholesale supply

67. The Applicant submitted that the distribution of carpet occurs through independent retailers, many of whom operate on a national level. Further, the Applicant submitted that prices are broadly equivalent in most areas of the country.
68. [] informed the Commission that they negotiate standard prices with buying groups and retailers, and that those prices are nationwide delivered prices. These parties informed the Commission that the prices do not vary from location to location.
69. Carpet can be packed efficiently into transport containers allowing for economic distribution on a nationwide basis. Accordingly, freight costs can be amortised across a large volume of carpet such that the freight component, on a per lineal metre basis, is relatively low.
70. Accordingly, the Commission concludes that it is appropriate to define a national geographic market, in respect of the manufacture/import and wholesale supply of carpet.

Conclusion on Market Definition

71. The Commission concludes that the relevant markets are:
- the North Island market for the supply of wool scouring services (the North Island scouring market); and
 - the national market for the manufacture/import and wholesale supply of carpet (the national carpet market).

COUNTERFACTUAL AND FACTUAL

72. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).⁶ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

⁶ *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No.6)*, (unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier), Para 42.

Factual

73. The Commission considers that the appropriate factual scenario is the acquisition by Godfrey Hirst of some or all of the assets of Feltex.

Counterfactual

74. The Commission considers that the following three scenarios are possible counterfactuals in this case:
- Feltex is acquired by another industry competitor;
 - Feltex exits the industry; or
 - Feltex is acquired by an independent third party (not currently involved in carpet manufacture).
75. The Commission was informed by [].
76. [].
77. Feltex informed the Commission that [].
78. [].
79. The Commission considers that, given the evidence above, the likely counterfactual scenario is that Feltex is acquired by an independent third party.

COMPETITION ANALYSIS**North Island Scouring Market***Existing Competition*

80. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).
81. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.
82. The Commission considers that a business acquisition is unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market

is below 70%, the combined entity (including any interconnected persons or associated persons) has less than in the order of 40% share; or

- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.
83. There are four scouring plants in the North Island. Godfrey Hirst owns 92.5% of CWS which operates a wool scour in Hawkes Bay. Feltex owns a scouring plant at Kakariki, Cavalier has a 92.5% ownership interest in Hawkes Bay Woolscourers Limited (HBWS), and New Zealand Wool Services International Limited (NZWS) own and operate a scour in Whakatu.
84. The following table represents the number of bales of wool scoured at each of the wool scours in the North Island, in the last year (2005-2006).

Table 1: Market Shares in North Island Wool Scouring Market 2005-2006

	Bales scoured	%
CWS (Godfrey Hirst)	[]	[]
Feltex Kakariki	[]	[]
<i>Combined entity</i>	[]	[]
HBWS (Cavalier)	[]	[]
Whakatu (NZWS)	[]	[]
Total	[]	100

Source: Commission estimates based on information supplied by industry participants.

85. Table 1 indicates that the combined entity would hold approximately [] of the market post acquisition, and the three firm concentration ration would be [] which would have increased from [] prior to the acquisition. This is outside the Commission's safe harbour guidelines.
86. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market, particularly in markets exhibiting product differentiation. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.
87. Cavalier informed the Commission that it uses approximately [] bales of wool scoured at the HBWS plant. The excess comprises wool scoured by exporters and brokers. Similarly, Godfrey Hirst informed the Commission that it uses [] bales of wool scoured at its CWS plant.
88. Norman Ellison informed the Commission that it does not have a wool scouring plant and typically []
- []

89. []
Similarly, []].
90. [] both wool exporters, informed the Commission that they had no concerns with the proposed acquisition in respect of wool scouring. [] said that there is enough competition in the market for wool exporters and all of the wool scours would have capacity to take on extra work if necessary.

Conclusion on the North Island Scouring Market

91. The Commission considers that the presence of two large competing scours (one being completely independent from carpet manufacturers), both with excess capacity, will be sufficient to constrain the combined entity in the factual, such that the acquisition is unlikely to result in a substantial lessening of competition in this market.

National Carpet Market

Existing Competition

92. There are currently four large manufacturers of carpet in the New Zealand market: Cavalier, Feltex, Godfrey Hirst and Norman Ellison. Windsor Carpets Limited (Windsor) and Sallee New Zealand Limited (Sallee) also produce tufted carpet but are significantly smaller than the larger four manufacturers.
93. The Commission was informed by Windsor that it is a much smaller operation than the four listed above, producing approximately [] lineal metres and an annual turnover of approximately \$[].
94. Lyn Chappell, Managing Director of Sallee informed that Commission that Sallee is a custom manufacturer of carpet specialising in very high end products. Ms Chappell stated that she did not consider that Sallee competed with the four manufacturers in Table 2 and that Sallee was very much a niche operator. Ms Chappell informed the Commission that Sallee produces approximately [] lineal metres and has a turnover of roughly \$[] from sales of that carpet. Sallee also imports some small quantities of carpet from Australia.
95. The Commission collected market share information from the four larger manufacturers which is presented in Table 2. The total sales figures are specified in lineal metres (which equates to 3.66 square metres) and total revenue from carpet sales.

Table 2: Market Shares in National Carpet Manufacture/Import Market 2005-2006

Manufacturer	Total sales (lineal metres)	%	Carpet sales revenue \$	%
Godfrey Hirst	[]	[]	[]	[]
Feltex	[]	[]	[]	[]
<i>Combined entity</i>	[]	[]	[]	[]
Cavalier Bremworth	[]	[]	[]	[]
Norman Ellison	[]	[]	[]	[]
Other imports	[]	[]	[] ⁷	[]
Total	[]	100	[]	100

Source: Commission estimates based on information supplied by industry participants.

96. Based on the figures in Table 2, post acquisition, the combined entity would hold [] of the market by total carpet sold (including imported carpet) and approximately [] of the market by revenue. The three firm concentration ratio would be [] by sales and [] by revenue, compared to [] and [] before the proposed acquisition. Both of these measures are outside the Commission's safe harbour guidelines.
97. Industry participants informed the Commission that manufacturers of carpet all compete vigorously, both between themselves and with imported carpet, which is becoming more prevalent. Most industry participants considered that this level of competition would continue, or possibly increase, post acquisition.

Near Entrants

98. The Commission was informed by []

].

99. []

].

Barriers to Expansion

100. Both Norman Ellison and Cavalier informed the Commission that they have a degree of existing excess capacity. Norman Ellison estimated that it could increase production by []

].

101. Cavalier estimated that it would have the capacity to increase its current production by approximately []

⁷ Commission estimate based on volume figures.

].

102. Accordingly, the Commission considers that the potential for existing competitors to expand easily and potentially manufacture an additional [] lineal metres, is a substantial competitive constraint on the actions of domestic producers, both in the factual and the counterfactual.

Imports

103. The Applicant submitted that the combined entity would continue to be constrained by competition from imports. The Applicant submitted that imports comprise 19% of the total carpet sold in New Zealand in the 2004/5 financial year. Further, it submitted that tariff duty on carpets is likely to be substantially phased out in the next few years.
104. Tariff duty attaches to imports sourced from countries other than Australia. Providing at least half of the content is of Australasian origin, imports from Australia attract no duty.
105. The Ministry of Economic Development (MED) informed the Commission that as at July 2006 the tariff attaching to imported carpet was 17% but this will be reduced in the coming years as outlined in Table 3.

Table 3: New Zealand Tariff Duty Payable on Carpet Imports

July 2006	July 2007	July 2008	July 2009
17%	15%	12.5%	10%

Source: Information provided by MED.

106. MED informed the Commission that tariff reductions in subsequent periods were to be discussed this year; however, these talks have been suspended until progress is made on the latest round of World Trade Organisation negotiations and the proposed free trade agreement with China.
107. [], advised the Commission that carpet could be easily sourced and imported from overseas. [] informed the Commission that he was currently happy with the terms of trade negotiated with the manufacturers in New Zealand, but at any point he could easily switch to importing carpet from Australia or even China.
- [], which is a retailer of flooring products, informed the Commission that all of the carpet sold by [] is imported. [] stated that there is no noticeable difference in quality or price between imported carpet and domestically produced carpet.
108. [], informed the Commission that it would be relatively simple to import carpet into New Zealand and that this carpet would compete head-on with domestically produced carpet. He stated that most imported carpet was synthetic
- []
-].
109. The Commission considers that imported carpet provides a competitive option which is likely to become even more competitive in the following few years as tariffs get reduced to 10%.

Countervailing Power

110. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition.
111. As discussed in the industry background section, the carpet industry is characterised by large buying groups who act as intermediaries between the customer and the manufacturer.
112. Typically, these buying groups negotiate supply terms and conditions for a number of independently owned stores.
113. [] informed the Commission that he considered the manufacturers could not afford to lose []. He stated that if the manufacturers chose to try and increase wholesale prices there would be a number of options open to the [] stores. Further, [] stated that it would be highly unlikely for the combined entity to attempt to raise wholesale carpet prices by five to ten percent because it would be critical for the combined entity to encourage support and faith in the Feltex brand being acquired. He stated that, in his view, the real asset being purchased by Godfrey Hirst was the 'Feltex' brand and that attempting to increase prices would seriously jeopardise the value of the transaction.
114. [] informed the Commission that [] holds a degree of negotiating power when dealing with suppliers due to the option of shifting more of its demand to an alternative manufacturer and the potential to import carpet easily.
115. The Commission considers that retailers of carpet hold a degree of countervailing power when negotiating supply terms, including prices, with manufacturers due to the ease with which these retailers, particularly the large buying groups, could switch to alternative manufacturers or to imports.

Conclusion on National Carpet Market

116. The Commission considers that given the presence of alternative carpet manufacturers, the presence of some excess capacity, the ease of importing carpet and the degree of countervailing power held by retailers of carpet, the proposed acquisition is unlikely to result in a substantial lessening of competition in this market.

OVERALL CONCLUSION

117. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the following markets:
- the North Island scouring market; and
 - the national carpet market.
118. The Commission considers that the relevant counterfactual is the purchase of Feltex by an independent third party, being an entity that does not currently have a presence in the carpet manufacturing industry.
119. In the North Island scouring market, the Commission considers that due to the level of existing competition in the market and the level of excess capacity held

by wool scourers, the proposal is unlikely to result in a substantial lessening of competition.

120. In the national carpet market, the Commission considers that given the presence of alternative established carpet manufacturers, the presence of some excess capacity, the ease of importing carpet and a degree of countervailing power held by retailers of carpet, the proposed acquisition is unlikely to result in a substantial lessening of competition.
121. Therefore, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market.

NOTICE OF CLEARANCE

122. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Godfrey Hirst of some or all of the assets of Feltex.

Dated this 31 August 2006

Paula Rebstock
Division Chair
Commerce Commission