

## Statement of Issues

### Fletcher Distribution/the Tumu companies

10 June 2022

#### Introduction

1. On 21 March 2022, the Commerce Commission registered an application (the Application) from Fletcher Distribution Limited (FDL), which operates PlaceMakers, seeking clearance to acquire six ITM stores and a frame and truss manufacturing plant from Tumu Merchants Limited (Tumu) (the Proposed Acquisition). The relevant ITM stores are located in Gisborne, Napier, Hastings, Havelock North, Dannevirke and Masterton and the frame and truss plant is in Hastings.<sup>1</sup>
2. As a result of the Proposed Acquisition, FDL or an interconnected body corporate of FDL, would acquire up to 100% of the shares in, or assets of, the following legal entities from Tumu:
  - 2.1 Tumu Gisborne Limited;
  - 2.2 Tumu Napier Limited;
  - 2.3 Tumu Hastings Limited;
  - 2.4 Tumu Havelock North Limited;
  - 2.5 Tumu Dannevirke Limited;
  - 2.6 Tumu Masterton Limited; and
  - 2.7 Tumu Frame & Truss Limited(the Tumu companies).
3. To grant clearance we must be satisfied that an acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.
4. This Statement of Issues (SoI) sets out the potential competition issues we have identified following our initial investigation. This is so FDL and Tumu and other interested parties can provide us with submissions relating to those concerns.

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<sup>1</sup> A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

5. In reaching the preliminary views set out in this Sol, we have considered information provided by FDL, Tumu and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition issues may arise, as the investigation continues.
6. The preliminary views expressed in this Sol are our views on whether the Proposed Acquisition is likely to substantially lessen competition in a relevant market or markets in New Zealand.
7. This is a different analysis to that being undertaken in the Residential Building Supplies Market Study, which is considering the factors that may affect competition for the supply or acquisition of key building supplies. The Market Study looks at whether competition for key building supplies is working effectively and, if not, why not and how competition could be improved.
8. Our work on the Residential Building Supplies Market study is ongoing and will consider a range of matters in addition to competition at a merchant/distribution level. The preliminary views we express in this Sol should not be taken as indicating the views that we may come to as part of the market study.

### **The concerns we are testing**

9. FDL and the Tumu companies both supply building products and related goods and services to trade and retail customers. Most relevant to the Application, both FDL and the Tumu companies overlap in the supply of building products in the Hawke's Bay and Wairarapa regions.
10. In reaching our preliminary views on the competition effects of the Proposed Acquisition, we have not formed a definitive view on the boundaries of any relevant markets.
11. We have compared the state of competition with the Proposed Acquisition relative to a counterfactual in which the Tumu stores are available to the ITM network (including when ITM competes for national customers), which we consider is the most competitive likely counterfactual.
12. We are currently not satisfied that the Proposed Acquisition would not be likely to substantially lessen competition. Specifically, the concerns that we are testing are whether the Proposed Acquisition would be likely to substantially lessen competition:
  - 12.1 in markets for the supply of building products to trade customers in the Wairarapa and Hawke's Bay due to unilateral effects; and
  - 12.2 in the market for the supply of building products to national trade customers (in particular group home builders) due to unilateral and/or coordinated effects.
13. At the regional level, the Proposed Acquisition would result in FDL acquiring a major rival in the supply of building products to trade customers in both the Wairarapa and Hawke's Bay regions. Service quality appears to be a significant differentiating aspect

of competition in the relevant regional customer markets. The evidence currently indicates that there is a distinct service quality component to the competitive offers of the Tumu companies that is not replicated by other merchants. We are concerned that this distinct service quality would be lost entirely or to a substantial degree with the Proposed Acquisition (and change of business culture). Moreover, we are currently not satisfied that competition from Carters and Mitre 10 would be sufficient to replace the competition lost when FDL acquires the Tumu companies to supply those customers.

14. We are also concerned that the Proposed Acquisition, could mean that ITM's ability to win and retain national customers could be significantly impeded. This could significantly undermine the competitive constraint ITM poses on FDL and Carters, which are the other main competitors for national customers. If ITM was to be less competitive in supplying national customers (including because it lacked a distribution presence in the Wairarapa, Hawke's Bay and East Coast regions), such customers may only have FDL and Carters as supply options, giving the merged entity the ability to increase prices or reduce quality. If ITM were to become less competitive in supplying national customers, then coordination between FDL and Carters could be easier to achieve and maintain.
15. We explain our reasons below and invite submissions on our preliminary views.
16. We have considered whether the Proposed Acquisition is likely to result in a substantial lessening of competition in the manufacture and supply of frame and truss. Our current view is that concerns are unlikely to arise in this regard. We also consider that the Proposed Acquisition is unlikely to substantially lessen competition in any markets due to vertical effects. Given this we do not consider frame and truss or vertical effects again in this Sol.

### Process and timeline

17. We have agreed with FDL to extend the period in which to make a decision from the initial 40 working day statutory timeframe until 28 July 2022.
18. We would like to receive submissions and supporting evidence from FDL, Tumu and other interested parties on the issues raised in this Sol. We request responses by close of business on **30 June 2022**, including a confidential and a public version of any submission made. Please read the instructions for making a submission, which can be found starting at paragraph 114 of this Sol.
19. All submissions received will be published on our website with appropriate redactions.<sup>2</sup> All parties will have the opportunity to cross-submit on the public versions of submissions from other parties by close of business on **11 July 2022**.

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<sup>2</sup> Confidential information must be clearly marked (by highlighting the information and enclosing it in square brackets). Submitters must also provide a public version of their submission with confidential material redacted. At the same time, a schedule must be provided which sets out each of the pieces of information over which confidentiality is claimed and the reasons why the information is confidential (preferably with reference to the Official Information Act 1982).

20. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) so that we can work with you to accommodate your needs where possible.

### **The parties**

21. FDL and the Tumu companies both supply building products and related goods and services to trade and retail customers.

#### **FDL**

22. FDL is a wholly owned subsidiary of Fletcher Building Limited. Fletcher Building Limited is a diversified building products company involved in the manufacture and distribution of building products, residential development and commercial construction. FDL owns and operates the national network of 62 PlaceMakers stores that sell building products and related goods and services, and also has eight frame and truss manufacturing plants located throughout New Zealand.
23. Most relevant to the Application, PlaceMakers has four stores in:
- 23.1 Hawke's Bay (Napier and Hastings);
  - 23.2 Wairarapa (Masterton); and
  - 23.3 Manawatū-Whanganui (Palmerston North),
- and a frame and truss plant in Taupō, from which it supplies the Hawke's Bay.

#### **Tumu**

24. The vendor, Tumu, forms part of the Tumu Group, a privately-owned group of companies. In addition to the companies that are the subject of the Proposed Acquisition, the Tumu Group has investments in wood manufacturing and processing, sawmilling, importing and wholesaling of building products, property investment and financing, and land and property development.
25. Relevant to the Application, the Tumu companies distribute and sell building products and related goods and services from six Tumu-branded store locations in the North Island. These stores are in:
- 25.1 Hawke's Bay (Napier, Hastings and Havelock North);
  - 25.2 Wairarapa (Masterton);
  - 25.3 Manawatū-Whanganui (Dannevirke); and
  - 25.4 Bay of Plenty (Gisborne),
- and its frame and truss manufacturing plant is located in Hawke's Bay (Hastings).

26. Until May 2022, each Tumu store traded under the ITM ('Independent Timber Merchants') brand. On 1 May 2022 the Tumu stores left the ITM co-operative and since then the Tumu stores have been operating as an independent building products merchant.

### The relevant markets

27. Market definition is a tool that helps identify and assess the competitive constraints that a merged entity would face.<sup>3</sup> Determining the relevant markets requires us to judge whether, for example, two products or services are sufficiently close substitutes to fall within the same market.
28. We define markets in the way that we consider best isolates the key competition issues that arise from a proposed merger or acquisition. This may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. A relevant market is ultimately determined, in the words of the Commerce Act 1986, as a matter of fact and commercial common sense.<sup>4</sup>

### FDL's view of the markets

29. In the Application, FDL submitted that the relevant markets for the supply of building products are regional markets for the retail supply of building products and related goods and services in the Hawke's Bay, Wairarapa and Manawatu-Wanganui.<sup>5</sup>
30. FDL submitted that trade and retail/DIY customers are supplied in the same market.<sup>6</sup> It submitted that:<sup>7</sup>
- 30.1 the same building products are generally suitable for both DIY and trade customers; and
- 30.2 competitors stock products suitable for DIY and trade customers and can readily adjust their product ranges in response to changes in consumer demand.
31. FDL further submitted that merchants such as FDL and ITM (as well as Mitre 10, Carters and Bunnings) sell building products in the same markets as category specialists (eg paint and decorating), direct suppliers (eg roofing materials manufacturers) and online building product retailers (eg, Trade Depot).<sup>8</sup>
32. Figure 1 shows a map of the regions in which the Tumu companies operate stores, and the stores that FDL and other merchants have in those regions.<sup>9</sup>

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<sup>3</sup> *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

<sup>4</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

<sup>5</sup> The Application at [29].

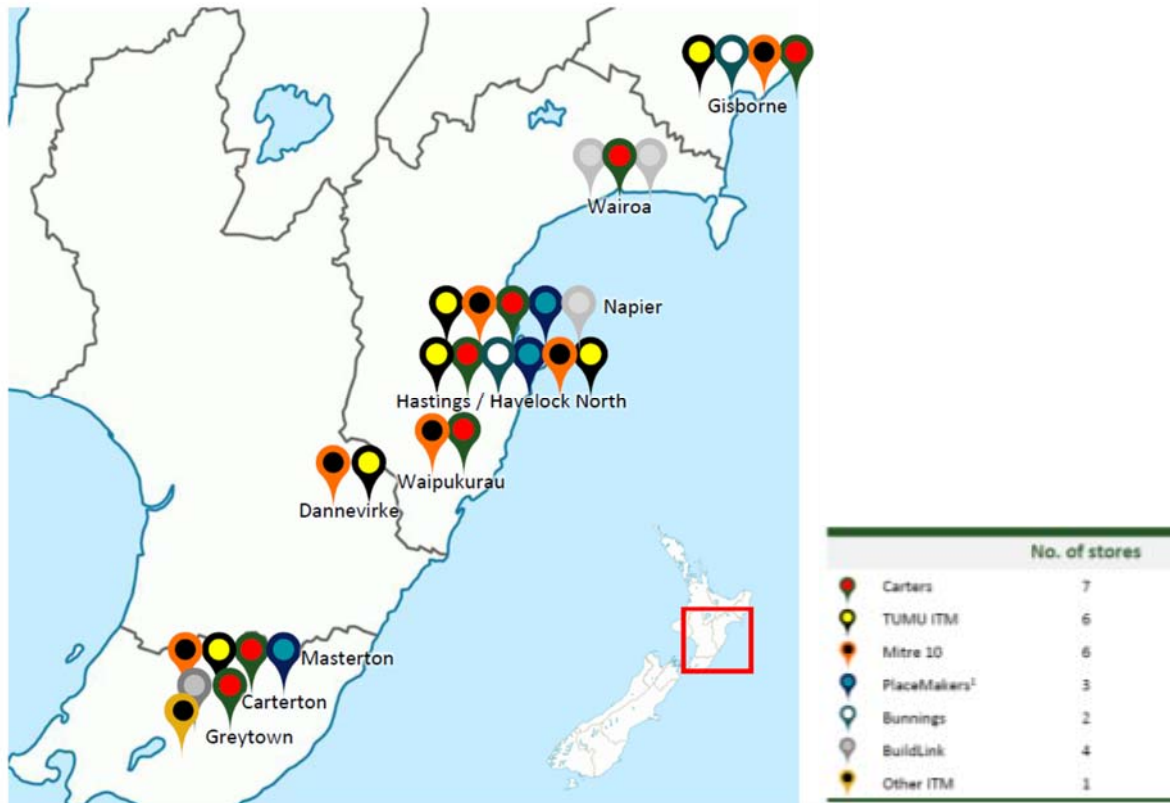
<sup>6</sup> The Application at [33.2].

<sup>7</sup> The Application at [48].

<sup>8</sup> The Application at [36]-[37].

<sup>9</sup> [ ]

**Figure 1: Overlapping regions**



33. On geographic market definition, FDL submitted that the precise geographic scope of the markets are unlikely to be determinative given the presence of competitors in even the narrowest of geographic markets. Nevertheless, it submitted that:<sup>10</sup>
- 33.1 it is appropriate to define regional markets for the supply of building products and related goods because:
- 33.1.1 most of the sales of FDL and the Tumu companies are delivered to customers, rather than customers purchasing and picking up products at a specific store; and
- 33.1.2 merchants, category specialists, online retailers and direct suppliers tend to supply customers on at least a regional basis;
- 33.2 the Hawke's Bay regional building products market includes Napier, Hastings and Havelock North and regional Hawke's Bay, but excludes Wairoa given its distance from Napier/Hastings;<sup>11</sup>
- 33.3 the Wairarapa regional building products market includes Masterton (where FDL and Tumu both have stores), plus Carterton, Greytown, Featherston and Martinborough;<sup>12</sup>

<sup>10</sup> The Application at [50]-[61], [64]-[65], [66.1], [72] and footnote 6.

<sup>11</sup> Based on where PlaceMakers in Napier delivered building products in FY21. The Application at [56]-[57].

<sup>12</sup> Based on where PlaceMakers in Masterton delivered building products in FY21. The Application at [54]-[55].

- 33.4 the Manawatū-Whanganui regional building products market includes Palmerston North (where FDL has a store) and Dannevirke (where there is a Tumu store);<sup>13</sup> and
- 33.5 it has not defined a Gisborne or East Coast regional building products market because FDL does not have a store in Gisborne and it only supplies a small amount of product into Gisborne.

#### **Our preliminary views of the relevant markets**

34. We have not yet formed a final view on market definition. For the reasons set out below, our preliminary view is that the relevant markets for assessing competitive effects of the Proposed Acquisition are, conservatively:

- 34.1 markets for the supply of building products to regional trade customers in each of the Wairarapa and the Hawke's Bay; and
- 34.2 the national market for the supply of building products to national trade customers.

#### *Product dimension*

35. Through the stores that they both operate, FDL and the Tumu companies overlap in the supply of building products. Given this, the appropriate starting point for market definition in this case is the supply of building products.
36. We have considered whether the different types of suppliers of building products (ie, merchants, category specialists, online building product retailers and direct suppliers) compete in the same relevant market. We agree with FDL that each of these suppliers stock similar building supply products that may be considered as substitutable with each other.
37. However, we have conservatively considered the impact of the Proposed Acquisition on the supply of building products by merchants only. At this stage we do not consider that category specialists, online building product retailers and direct suppliers compete with merchants in the relevant market, because:
- 37.1 a merchant only market reflects the overlap between FDL and the Tumu companies; and
- 37.2 based on the evidence gathered to date it appears that, although there is a degree of substitution between different types of suppliers, trade customers in the regions in which FDL and Tumu mainly overlap buy the majority of their building products through merchants.<sup>14</sup>

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<sup>13</sup> Based on where PlaceMakers in Palmerston North delivered building products in FY21. The Application at [58].

<sup>14</sup> See, for example, [ ].

38. We are still considering the precise scope of the product dimension of the market and invite submissions on the extent to which merchants sell building products to customers in the same markets as category specialists, direct suppliers and online building product retailers, or whether merchants sell building products in separate markets to such parties.

#### *Customer dimension*

39. FDL, the Tumu companies and other suppliers of building supply products supply customers that are differentiated by size, with large trade customers (eg, group home builders) at one end of the spectrum and smaller retail/DIY customers at the other.
40. Our current view is that the key competition issues that may arise from the Proposed Acquisition are best isolated by assessing a separate customer market for the supply of building products to trade customers via merchants.
41. We have conservatively considered the impact of the Proposed Acquisition on the supply of building products to trade customers, because:
- 41.1 this is the main area of overlap between FDL and the Tumu stores; and
- 41.2 based on the evidence gathered to date it appears that the requirements of trade customers may differ between retail/DIY customers, so that fewer suppliers can fulfil their demand.<sup>15</sup>
42. We are still considering the precise scope of the customer dimension of the market and invite submissions on the extent to which it is appropriate to define separate markets for trade and retail/DIY customers.

#### *Geographic dimension*

43. Our current view is that the key competition issues that may arise from the Proposed Acquisition are best assessed by defining separate markets for the supply of building products to regional trade customers and national trade customers (predominantly group home builders). Based on the evidence gathered so far it appears that there are different options available to national and regional trade customers. We discuss this further below.

#### Regional markets

44. Evidence indicates that a very high proportion of building product purchases by trade customers are delivered to customers regardless of whether those customers are local or national customers.<sup>16</sup> Evidence also indicates that deliveries from a particular store are clustered within the town in which a store is and generally spread out from

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<sup>15</sup> For example, trade customers demand building products that are built to a certain standard (ie, to a structural grade of timber). [ ]

<sup>16</sup> See, for example, [ ].



that location within a region.<sup>17</sup> This suggests that there are regional markets for the supply of building products by merchants to trade customers.

45. As Figure 1 shows, FDL and the Tumu companies overlap to a material degree in the supply of building products in two regions only: the Wairarapa and Hawke's Bay. Both FDL and the Tumu companies operate building products stores in Masterton, Napier and Hastings. The Tumu companies also operate a third store in the Hawke's Bay in Havelock North. At this stage, on a conservative basis, we have separately considered the impact of the Proposed Acquisition on the supply of building products to trade customers in each of the Wairarapa and Hawke's Bay regions.
46. While the Tumu companies also operate building products stores in Gisborne and in Dannevirke, FDL has no stores in either location and only small sales in each location. FDL supplies a small amount of product into Gisborne from other regions.<sup>18</sup> Similarly, FDL supplies a small amount of product into Dannevirke from Palmerston North.<sup>19</sup> Given this, we do not consider further in this Sol the supply of building products to regional trade customers in Gisborne or Dannevirke. However, as we explain further in section below, these regions are relevant to our assessment of the impact of the Proposed Acquisition on the supply of building products to national customers.

#### National market

47. National trade customers negotiate with merchants the terms of supply of building products on a national or multi-regional basis. This suggests that merchants require at least a multi-regional network to be able to compete for national trade customers and that these customers may have different supply options to regional customers for whom a network of stores is not necessary.<sup>20</sup>
48. Defining a separate national customer market therefore allows us to assess any distinct impacts of the Proposed Acquisition on national customers, in addition to impacts on regional customers.
49. However, we are still considering the precise scope of the relevant markets and invite submissions on the extent to which the supply options for national customers are different to those of regional customers.

#### **With and without scenarios**

50. Assessing whether a substantial lessening of competition is likely requires us to:
- 50.1 compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the Proposed Acquisition, often referred to as the factual)

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<sup>17</sup> The Application at Attachment 16, [ ].

<sup>18</sup> The Application at Attachment 2.

<sup>19</sup> [ ] The Application at Attachment 16.

<sup>20</sup> In many regions, regional customers may have supply options that include FDL, Carters, ITM, Mitre 10 and Bunnings. However, national customers mainly have only FDL, Carters and ITM as supply options.

with the likely state of competition if it does not (the scenario without the Proposed Acquisition, often referred to as the counterfactual); and

- 50.2 determine whether competition is likely to be substantially lessened by comparing those scenarios.

### The factual

51. With the Proposed Acquisition, FDL would acquire six building products stores located in Gisborne, Napier, Hastings, Havelock North, Dannevirke and Masterton (and a frame and truss manufacturing plant in Hastings) from Tumu.
52. As noted earlier, until May 2022, each Tumu store traded under the ITM brand. On 1 May 2022 the Tumu stores left the ITM co-operative and since then the Tumu stores have been operating as an independent building products merchant. With the Proposed Acquisition, the Tumu stores would be rebranded as Tumu PlaceMakers.<sup>21</sup>
53. FDL submitted that the Proposed Acquisition is an opportunity for FDL to fill gaps in its geographic coverage in areas of the North Island, [ ]. There are also synergies to be achieved from the Proposed Acquisition.<sup>22</sup>

### The counterfactual

54. In the Application, FDL submitted that the counterfactual is the status quo, whereby the Tumu stores would continue to operate under the ITM brand (either under Tumu ownership or the ownership of a third-party) and FDL would continue to operate in Gisborne, the Wairarapa and Hawke's Bay as it does today ([ ]).<sup>23</sup>
55. At this stage, we consider that a likely counterfactual is the status quo.<sup>24</sup> We are also exploring whether the Tumu companies could be sold to an alternative purchaser. This could include one of the remaining merchants, and in particular ITM. The Tumu stores leaving ITM means that it no longer has any material presence in the Hawke's Bay or Wairarapa. This could give ITM (or a shareholder of the ITM co-operative) the incentive to buy the Tumu stores in the counterfactual so that they can operate as ITM stores and ITM can regain national geographic coverage. On a conservative basis, our analysis in this Sol is against a counterfactual where the Tumu stores are

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<sup>21</sup>

[ ]

<sup>22</sup> The Application at [22]-[24],  
[

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<sup>23</sup> The Application at [26] and Commerce Commission pre-notification discussion meeting with FDL (25 November 2021).

<sup>24</sup> The status quo is where the Tumu stores would remain under Tumu Group ownership and be operated as independent building products merchants, outside of ITM (as has been the case since 1 May 2022).

available to the ITM network (including when ITM competes for national customers). We continue to assess whether this is likely and invite submissions on this point.

56. Tumu advised that [ ]<sup>25</sup> Tumu told us that [ ]<sup>26</sup>

57. Tumu engaged [ ] to advise and assist with a sales process it ran in 2021.<sup>27</sup> [ ]<sup>28</sup> Tumu indicated that, absent a sale to FDL, it would [ ]<sup>29</sup>

58. [ ]<sup>30</sup>

59. [ ]<sup>31</sup>

<sup>25</sup> E-mail from Tumu to the Commerce Commission (23 May 2022).

<sup>26</sup> Commerce Commission interview with Tumu (6 May 2022).

<sup>27</sup> [ ] and Commerce Commission interview with Tumu (6 May 2022).

<sup>28</sup> [ ] and Commerce Commission interview with Tumu (6 May 2022).

<sup>29</sup> Commerce Commission interview with Tumu (6 May 2022).

<sup>30</sup> [ ]

<sup>31</sup> [ ]

[  
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60. In the remainder of this Sol, we have assessed the Proposed Acquisition against a counterfactual where the Tumu stores are available to the ITM network (including when ITM is competing for national customers).
61. We invite submissions on the appropriate without the Proposed Acquisition scenario.

### **Competition concern: horizontal unilateral effects in regional markets**

62. Horizontal unilateral effects arise when a firm merges with or acquires a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors, if any) such that the merged entity can profitably increase price above (and/or reduce quality below) the level that would prevail without the merger.
63. For the reasons set out below, we are not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects in the supply of building products to regional trade customers in the Wairarapa and Hawke's Bay, relative to a counterfactual scenario where the Tumu stores are available to the ITM network.

### **FDL's submissions**

64. In the Application, FDL submitted that the Proposed Acquisition would not be likely to substantially lessen competition in any regional building products markets due to unilateral effects because:<sup>32</sup>
- 64.1 the Proposed Acquisition would lead to a modest market share aggregation, and FDL and the Tumu companies are not each other's closest competitor;
  - 64.2 there are other competitors in each relevant region, including other merchants (including ITM stores) and category specialists;
  - 64.3 strong price competition between merchants would remain post-Acquisition;
  - 64.4 new entry and expansion by merchants (including ITM) is likely; and
  - 64.5 category specialists and direct suppliers account for over half of building product sales.

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<sup>32</sup> The Application at [68] and [88].

65. FDL further submitted that the Proposed Acquisition would not result in any loss of competition due to reduction in service quality. This is because:<sup>33</sup>
- 65.1 FDL is retaining the Tumu stores and the Tumu staff to continue to service customers as the Tumu companies have done to date;
- 65.2 if it were the case that Tumu's sales were driven by some unique level or type of service that was profit maximising and competitively significant today, it is difficult to see why FDL would not continue to offer that level or type of service post-Acquisition; and
- 65.3 if FDL decided to remove or reduce any unique level or type of service that the Tumu companies provide, this would provide an opportunity for another merchant to replace the service currently provided by the Tumu companies, and there are no barriers to other merchants doing so.

#### **Our unilateral effects concerns in regional customer markets in this case**

66. On the basis of the evidence currently before us, we are not satisfied that existing competition from existing competitors Carters and Mitre 10 (and Bunnings in Hastings) is likely to sufficiently constrain the merged entity for the supply of building products to regional trade customers in either the Hawke's Bay or the Wairarapa.

#### *The merged entity would have significant market share*

67. The Proposed Acquisition would result in FDL acquiring a significant competitor for the supply of building products to trade customers in both the Wairarapa and Hawke's Bay regions.
68. Table 1 sets out estimated market shares in the supply of building products to trade customers in the Wairarapa. Table 2 sets out estimated market shares in the supply of building products to trade customers in the Hawke's Bay. We note that the figures include any sales of building products to national customers in each region for 2021. The market shares are only for the supply of building products through the main merchants (ie, exclude sales by specialist and other suppliers).

**Table 1: Estimated market shares for Wairarapa trade customers, 2021**

<b>Supplier</b>	<b>Sales revenue (\$000s)</b>	<b>Share (%)</b>
Tumu	[ ]	[ ]
FDL	[ ]	[ ]
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]</b>
Carters	[ ]	[ ]
Mitre 10	[ ]	[ ]
Bunnings	No store	
<b>Total</b>	<b>[ ]</b>	<b>100</b>

<sup>33</sup> E-mail from A&B Lawyers (on behalf of FDL) to the Commerce Commission (17 May 2022).

**Table 2: Estimated market shares for Hawke’s Bay trade customers, 2021**

Supplier	Sales revenue (\$000s)	Share (%)
Tumu	[ ]	[ ]
FDL	[ ]	[ ]
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]</b>
Carters	[ ]	[ ]
Mitre 10	[ ]	[ ]
Bunnings	[ ]	[ ]
<b>Total</b>	<b>[ ]</b>	<b>100</b>

69. Based on the above, Tumu is the number one supplier in both the Wairarapa and the Hawke’s Bay. The merged entity would have an estimated [ ]% market share in the market for the supply of building products to all trade customers in the Wairarapa region. The merged entity would have an estimated [ ]% market share in the market for the supply of building products to all trade customers in the Hawke’s Bay region. However, we note that FDL [ ] and is likely to continue to do so post-Acquisition.<sup>34</sup>

*Level of constraint from remaining merchants*

70. While Carters and Mitre 10 would remain as competitors in both the Wairarapa and Hawke’s Bay (and Bunnings would remain in Hastings), their market shares would be significantly smaller than the market share of the combined entity. While some evidence pointed to constraint from both Carters and Mitre 10, some customers also see Mitre 10 and Bunnings as less trade focussed and not as good an alternative to the merged entity, noting:

70.1 a reluctance to go to Mitre 10, as it is a less accessible trade store,<sup>35</sup> and

70.2 the Proposed Acquisition will leave only two trade focussed merchants.<sup>36</sup>

71. In terms of price, one customer told us that they use the Tumu companies to price check the pricing of FDL or Carters, and expressed concern that they would lose this price tension with the Proposed Acquisition.<sup>37</sup> The same customer told us that the Tumu companies are more price aggressive than FDL.<sup>38</sup>

*Potential for the Proposed Acquisition to result in a significant decline in service quality*

72. The evidence currently before us also indicates that service quality is a significant aspect of competition in the relevant regional customer markets. A lessening of

<sup>34</sup> FDL has only opened its store in Masterton in the last three years and [ ].

<sup>35</sup> [ ]

<sup>36</sup> [ ]

<sup>37</sup> [ ]

<sup>38</sup> [ ]

competition or an increase in market power may manifest itself through a reduced service quality.

73. Many customers referred to the high levels of service quality provided by the Tumu companies. Evidence from such customers (set out below) suggested that the superior location of the Tumu stores, its stock levels and the level of service offered influences their decision to buy building products from the Tumu companies.

73.1 Tumu has the best stock and would like to switch all supply to it (if not for national supply agreement). Have found it difficult to deal with FDL.<sup>39</sup>

73.2 Tumu provides exceptional service and supports community projects. Have a great relationship with Tumu and site is in a great location.<sup>40</sup>

73.3 Tumu service is a lot better than other merchants', have great products and location of its stores is an advantage.<sup>41</sup>

73.4 Tumu offers good service and have had little delays or shortages getting products from Tumu (due to its pulling power). Have great relationship with Tumu.<sup>42</sup>

73.5 Tumu is best supplier in terms of price and service, and has superior stock levels.<sup>43</sup>

73.6 Tumu store size/stock is better than FDL. Service from Tumu is also better as it has its own trucks.<sup>44</sup>

73.7 Tumu provides good service and its stores in the Hawke's Bay are in convenient locations, compared to FDL's which are in a bad locations.<sup>45</sup>

73.8 Location of Tumu stores in the Hawke's Bay are convenient.<sup>46</sup>

73.9 Location of Tumu store in Havelock North is convenient and Tumu is quick to resolve issues. Have a long standing relationship with Tumu and hope this remains the same post-Acquisition.<sup>47</sup>

73.10 Tumu provides good service and has the largest range/stock – it has been able to supply products when other merchants could not. It would be a

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39 [ ]  
40 [ ]  
41 [ ]  
42 [ ]  
43 [ ]  
44 [ ]  
45 [ ]  
46 [ ]  
47 [ ]

concern if service levels (eg, delivery timeframes) were to deteriorate with the Proposed Acquisition.<sup>48</sup>

73.11 Tumu dominates the market due to its strong focus on maintaining relationship with customers.<sup>49</sup>

73.12 Buy from Tumu because of supply relationship with sales rep.<sup>50</sup>

74. The above evidence suggests that there is a distinct service quality component to the competitive offers of the Tumu companies that is not currently replicated by other merchants. Some aspects of this service quality (in particular the location of the Tumu stores) would not change with the Proposed Acquisition. However, we are currently not satisfied that this distinct service quality would not be lost to a substantial degree with the Proposed Acquisition compared to the counterfactual.

75. FDL advised that  
[

].<sup>51</sup>

76. We acknowledge that any assessment of non-price competition is subjective. We are continuing to investigate this point and invite submissions on:

76.1 how the service quality of the Tumu companies compares to that of other merchants in the Wairarapa and Hawke’s Bay, including why Tumu’s service is perceived by many customers as being superior;

76.2 whether the service quality of the Tumu companies would be different with the Proposed Acquisition under the ownership of FDL, compared to a counterfactual where the Tumu stores are available to the ITM network ; and

76.3 whether remaining competitors in the Wairarapa and Hawke’s Bay would have incentives to improve their service offering to replace that lost as a result of the Proposed Acquisition, so that customers could switch to rival merchants.

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48 [ ]

49 [ ]

50 [ ]

51 The Application at [98], Commerce Commission pre-notification discussion meeting with FDL (25 November 2021) and e-mail from A&B Lawyers (on behalf of FDL) to the Commerce Commission (24 May 2022), plus  
[

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### Entry or expansion is not likely to be sufficient in extent or timely to constrain

77. To constrain an exercise of market power by the merged entity, entry or expansion in response to a price increase or other exercise of market power by the merged entity has to be likely, sufficient in extent, and in a timely fashion, satisfying what is termed the 'LET test'.<sup>52</sup> While we look at evidence of whether parties are already planning to enter or expand (and consider the impact of that entry or expansion), what matters for our analysis is whether entry and expansion in addition to that already planned would be likely if prices increased post-acquisition.<sup>53</sup>
78. On the basis of the evidence currently before us, we are not satisfied that, in response to a significant increase in price or decline in quality, an existing or potential merchant competitor would be likely to expand/enter in the Wairarapa and Hawke's Bay on a sufficient scale and in a timely manner to constrain the merged entity.
79. The evidence currently before us indicates that barriers to entry and expansion in the Wairarapa and Hawke's Bay regional customer markets are high, and that new entry is unlikely in the next three to five years. Rival merchants are also unlikely to expand to a sufficient extent within three to five years.
80. [ ]<sup>54</sup>  
 [ ]<sup>55</sup> FDL  
 acknowledged that [ ]<sup>56</sup>
81. ITM has told us that it is likely to face barriers re-entering the Wairarapa and Hawke's Bay.
- 81.1 ITM told us that  
 [ ]<sup>57</sup>
- 81.2 [ ]

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<sup>52</sup> Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019) at [3.95]-[3.96].

<sup>53</sup> Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019) at [3.99].

<sup>54</sup> [ ]

<sup>55</sup> Commerce Commission pre-notification discussion meeting with FDL (25 November 2021).

<sup>56</sup> Commerce Commission pre-notification discussion meeting with FDL (25 November 2021).

<sup>57</sup> E-mail from ITM external legal counsel to the Commerce Commission (29 April 2022) and Commerce Commission interview with ITM (29 April 2022).

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81.3 ITM advised that

[

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82. While Mitre10

[

].<sup>60</sup>

83. Bunnings is currently a very small player in the market for the supply of building products to Hawke's Bay trade customers (with only a single store in Hastings) and has no presence at all in the Wairarapa. While possible, there is no evidence before us to indicate that entry or expansion by Bunnings to supply trade customers in these regions is likely to occur to a sufficient extent in a timely manner. Bunnings told us that

[

].<sup>61</sup> FDL told us that it understood that Bunnings

[

].<sup>62</sup> Bunnings advised that,

[

].<sup>63</sup>

84. A further barrier to entry/expansion may arise from land covenants. In at least the Hawke's Bay region, covenants on some residential land development heavily influence or dictate the merchant through whom building products are purchased by trade customers. The effect of any covenants is to reduce the contestable market for new entrants (or merchants that expand), which could impact on entry or expansion. Evidence indicates that these covenants may apply to a not immaterial portion of land development in the Hawke's Bay. Several parcels of land have covenants in favour of Tumu, and FDL will gain the benefits of these covenants with the Proposed Acquisition.

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<sup>58</sup> E-mail from ITM external legal counsel to the Commerce Commission (29 April 2022), Commerce Commission interview with ITM (29 April 2022) and e-mail from ITM to the Commerce Commission (18 May 2022).

<sup>59</sup> Commerce Commission interview with ITM (29 April 2022).

<sup>60</sup> Commerce Commission interview with Mitre 10 (12 May 2022).

<sup>61</sup> E-mail from Bunnings to the Commerce Commission (6 May 2022).

<sup>62</sup> The Application at 2.

<sup>63</sup> E-mail from Bunnings to the Commerce Commission (6 May 2022).

84.1 ITM told us that

[

].<sup>64</sup>

84.2 Some customers in the Hawke’s Bay indicated that they have had to use the Tumu stores or Mitre 10 (rather than their normal supplier) for construction projects on land that has covenants, except if the merchant has an issue supplying the building products.<sup>65</sup> Some customers also suggested that there may be covenants on some land in the Wairarapa that favours particular merchants.<sup>66</sup>

84.3 [

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[

].<sup>68</sup>

84.4 Mitre 10 told us that its land development activities have contributed to its growth in the Hawke’s Bay, potentially accounting for [ ]% of its growth.<sup>69</sup> Tumu estimated that up to [ ]% of the sales of the Tumu stores in the Hawke’s Bay were generated from covenants on land. Tumu estimated that [ ]% of the residential land to be developed in the Hawke’s Bay may have covenants on it in favour of the Tumu stores or Mitre 10. The covenants currently favouring Tumu stores will shift to FDL with the Proposed Acquisition.<sup>70</sup>

85. We welcome submissions on this preliminary view, including:

85.1 barriers to entry/expansion;

85.2 the likely timeframe for entry; and

85.3 the potential impact of covenants in the Hawke’s Bay and Wairarapa.

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<sup>64</sup> E-mail from ITM to the Commerce Commission (29 April 2022) and Commerce Commission interview with ITM (29 April 2022).

<sup>65</sup>

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<sup>66</sup>

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<sup>67</sup>

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<sup>68</sup>

Commerce Commission pre-notification discussion meeting with FDL (25 November 2021).

<sup>69</sup>

Commerce Commission interview with Mitre 10 (12 May 2022).

<sup>70</sup>

Commerce Commission interview with ITM (29 April 2022).

## Competition concern: horizontal unilateral effects in the supply of building products to national trade customers

86. For the reasons set out below, we are not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects in the supply of building products to national trade customers, relative to a counterfactual scenario where the Tumu stores are available to the ITM network when ITM competes for national customers.

### FDL's submissions

87. FDL submitted that the Proposed Acquisition would not lessen competition, substantially or otherwise, in the national market for the supply of building products to national (or group home builder) customers. This is because:<sup>71</sup>

87.1 the Proposed Acquisition would not change the options available to group home builders when they go to tender. Group home builders will have at least FDL, Carters, ITM, Bunnings and Mitre 10 as supply options in both the factual and the counterfactual;

87.2 the only change with the Proposed Acquisition is that the six Tumu stores would be part of FDL's network of stores. While these stores would improve FDL's overall offer, other merchants will likely respond by improving their own overall offers (eg, by altering pricing or other terms of their offers, or by ITM re-establishing stores in the regions where the Tumu stores operate); and

87.3 it is not clear what role the Tumu stores would play in any national customer market in the counterfactual, as the Tumu stores ceased being ITM stores on 1 May 2022 and part of any ITM offer or competition for national customers. Even if the Tumu stores re-joined ITM, this would just change the relative importance that each of FDL and ITM would place on various parts of their overall offers and would not lead to an intrinsically more competitive outcome than that with the Proposed Acquisition.

88. FDL provided estimates of market shares in the national market for the supply of building products to national or group home builder customers. These market share estimates are set out in Table 3 below.<sup>72</sup>

**Table 3: Estimated market shares national customers**

Supplier	Share (%)
Carters	[ ]
FDL	[ ]
ITM	[ ]
Mitre 10	[ ]
Bunnings	[ ]
<b>Total</b>	<b>100</b>

<sup>71</sup> E-mail from A&B Lawyers (on behalf of FDL) to the Commerce Commission (17 May 2022).

<sup>72</sup> E-mail from A&B Lawyers (on behalf of FDL) to the Commerce Commission (17 May 2022).

### Our current view

89. With the Proposed Acquisition, compared to a counterfactual where the Tumu stores are available to the ITM network when ITM competes for national customers, ITM will have a substantially reduced presence in the Hawke's Bay and Wairarapa (plus Dannevirke and Gisborne).
90. We are considering how this affects ITM's ability to compete to supply trade customers who contract nationally with building products merchants (eg, group home builders) and how it would affect competition in the national market for the supply of building products to national trade customers.
91. While the evidence is mixed, we are concerned that, compared to the counterfactual above, an effect of the Proposed Acquisition would be to impact ITM's network of stores and weaken its ability to compete for contracts to supply national trade customers, including winning new customers. This could significantly undermine the competitive constraint ITM imposes on FDL and Carters and may mean that such customers only have FDL and Carters as supply options. Given that many national customers have both a primary and secondary merchant supplier, this reduction from three to two options could significantly impact national trade customers' ability to secure competitive terms from merchants and may enable the merged entity to increase its prices.
92. There are only three merchants that actively compete to supply national customers: FDL, Carters and ITM. As Table 3 shows, Mitre 10 and Bunnings have a small share of the national customer market. Mitre 10 told us that  
[  
].<sup>73</sup>
93. FDL advised, in discussing the rationale for the Proposed Acquisition, that  
[  
].<sup>74</sup> This indicates that FDL expects that the Proposed Acquisition would improve the competitiveness of its offering to national customers, relative to the counterfactual. Evidence indicates that this would be at the expense of ITM's competitiveness in the market for the supply of building products to national trade customers.
94. Many group home builders indicated that the geographic presence of a merchant is a significant factor in their decisions on choice of suppliers.<sup>75</sup>

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<sup>73</sup> Commerce Commission interview with Mitre 10 (12 May 2022).

<sup>74</sup> Commerce Commission pre-notification discussion meeting with FDL (25 November 2021).

<sup>75</sup>

[

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95. ITM expressed the view that [ ]<sup>76</sup> ITM also advised that [ ]<sup>77</sup> ITM also told us that [ ]<sup>78</sup>

96. For these reasons, we are currently not satisfied that the Proposed Acquisition would not result in price rises or a reduction in quality (ie, unilateral effects) in the supply of building products to national trade customers.
97. We are continuing to investigate this point and invite submissions on:
- 97.1 the competitive constraint currently provided by ITM in the national market for the supply of building products to national trade customers;
  - 97.2 the likelihood of ITM losing the entire business of any of its existing national customers with the Proposed Acquisition;
  - 97.3 the extent to which ITM would remain a supply option for national customers with the Proposed Acquisition;
  - 97.4 the impact of the Proposed Acquisition on ITM's ability to compete with FDL and Carters for national customers in the future; and
  - 97.5 the significance for our analysis of national customers sourcing building products from more than one merchant (with some having a main and secondary supplier).

### **Competition concern: coordinated effects regarding national customers**

98. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all, or some, of its remaining rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. Unlike unilateral effects, which can arise from the merged entity acting on its own, coordinated effects require some or all the firms in the market to be acting in a coordinated way.

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<sup>76</sup> Commerce Commission interview with ITM (29 April 2022).

<sup>77</sup> E-mail from ITM to the Commerce Commission (18 May 2022).

<sup>78</sup> E-mail from ITM to the Commerce Commission (24 May 2022).

99. For the reasons set out below, we are not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects in the supply of building products to national customers, relative to a counterfactual scenario where the Tumu stores are available to the ITM network when ITM competes for national customers.

#### **FDL's submissions**

100. In the Application, FDL submitted that the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects due to the numerous competitors that would remain, as well as because:<sup>79</sup>
- 100.1 it would be impossible to reach any form of tacit coordination with competitors where quoted pricing is specific to particular jobs; and
- 100.2 in respect of shelf prices, the thousands of SKUs stocked in each store would make it impossible for competitors to reach and enforce a tacit understanding about prices for these products.

#### **Our current view**

101. At this stage, we are not satisfied that the market for the supply of building products to national trade customers is not vulnerable to coordination, or that the Proposed Acquisition would not be likely to change conditions in that market to make coordination more likely, more complete or more sustainable.
102. We consider that there are market conditions that may create the conditions for coordination; for example, the small number of merchants active in the supply of building products to national trade customers, the existence of high barriers to entry and/or expansion in the relevant market, and visibility of price and other terms of service through the existence of multiple contracts between merchants and many national customers. There is likely to also be frequent market interactions between merchants through a variety of industry forums and through common suppliers of building supply products.

#### *Market concentration*

103. A small number of competitors can increase the likelihood of coordination, particularly in the absence of a particularly vigorous competitor or strong competition from outside any coordinating firms. The Proposed Acquisition could lead to further concentration in the national customer market if it results in ITM becoming less competitive in supplying building products to national customers. This change in market structure could make it easier to establish and sustain coordinated conduct because it is easier to reach and monitor coordination with only one significant rival than with two.
104. Regardless of how competition for national customers occurs (ie, through tenders or otherwise), any coordination is likely to become easier to establish and sustain with fewer competitors in the market. In a concentrated market, firms may also have less

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<sup>79</sup> The Application at [127].

incentive to deviate from a coordinated outcome. We are still considering whether the frequency with which national contracts are awarded to trade merchants may facilitate ongoing monitoring and punishment of any deviation from a coordinated agreement in the national customer market.

*Industry relationships and market transparency*

105. We are also considering whether the existence of multi-market contacts and the frequency of market interaction between building supply merchants through a variety of industry forums may make the national customer market more vulnerable to coordination. The more extensive the overlap in the markets that the firms serve, the larger are the benefits of coordination and the costs of deviating from a coordinated outcome.
106. Many national customers also have contracts with more than one merchant, which may have the potential to increase information sharing between competing building supply merchants due to visibility of price and other terms of service between merchants. In markets where firms can observe each other's prices, volumes or other terms of service it could potentially make reaching and sustaining coordination more likely, as any attempt to deviate from the coordinated outcome is more likely to be detected and punished.
107. Further, we consider that the market transparency created through the existence of large national contracts between merchants and trade customers means that FDL and Carters may be more likely to be able to reach, monitor and sustain a coordinated agreement involving customer and/or geographic market allocation. Market allocation means that merchants would not need to agree on a price and/or non-price factors such as terms of service over which to coordinate. Instead, each merchant would be free to set the price and other terms and conditions of the bundle of services provided to their own customers that have been allocated to them. The simplicity of such an agreement, combined with the concentrated nature of the relevant market, may therefore make the national customer market more vulnerable to firms reaching and sustaining a coordinated agreement on customer and/or geographic market allocation.
108. We note that the Commission has previously investigated coordinated conduct by FDL in at least one other regional building products market. In 2013-2014, the Commission investigated and undertook litigation in terms of an understanding FDL and Carters to fix the price for the supply of structural timber for commercial jobs in Auckland.<sup>80</sup> We consider that even if FDL and Carters did not coordinate their pricing to national customers, there remains a risk that coordination could occur with respect to the allocation of customers.
109. Our current view is that any attempts by the remaining firms to coordinate in the supply of building products to national customers are unlikely to be prevented by new entry or the threat of it occurring. Further, we are also of the preliminary view

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<sup>80</sup> <https://comcom.govt.nz/news-and-media/media-releases/2013/commission-commences-proceedings-in-relation-to-auckland-timber-cartel> and <https://comcom.govt.nz/news-and-media/media-releases/2014/carter-holt-harvey-fined-for-classic-price-fixing-breaches>.



that there is little evidence to suggest that national customers will have sufficient countervailing power to destabilise a coordinated agreement between building supply merchants.

110. However, we have also identified some market conditions which make the market less vulnerable to coordination. These include:
- 110.1 the fact that the prices charged by merchants to national trade customers are not readily observable (both before and after rebates); and
  - 110.2 the presence of supply shocks and volatility in demand.
111. We are continuing to consider the risk of possible coordination resulting from the Proposed Acquisition and invite submissions on:
- 111.1 the extent to which the market for the supply of building products to national customers is vulnerable to coordination;
  - 111.2 whether the Proposed Acquisition changes the conditions in the market for the supply of building products to national trade customers so that coordination is more likely, more complete, or more sustainable;
  - 111.3 the existence of countervailing power by national customers that would undermine any attempts by merchants to coordinate;
  - 111.4 whether ITM is a destabilising factor in the supply of building products to national trade customers, such that any reduction in the competitiveness of ITM with the Proposed Acquisition could make coordination in this market more likely.

### **Next steps in our investigation**

112. We are currently scheduled to decide whether or not to give clearance to the Proposed Acquisition by 28 July 2022. However, this date may change as our investigation progresses. In particular, if we need to test and consider the issues identified above further, the decision date may extend.
113. As part of our investigation, we are identifying and contacting parties that we consider will be able to help us assess the issues identified above.

### **Making a submission**

114. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. We welcome any further evidence and other relevant information and documents that FDL, Tumu or any other interested parties are able to provide regarding the issues identified in this Sol.
115. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference "FDL/Tumu" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **30 June 2022**.

116. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.