IN THE HIGH COURTOF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2015-404-002719
[2016] NZHC 1262

UNDER	the Commerce Act 1986
BETWEEN	GODFREY HIRST NZ LIMITED Appellant
AND	COMMERCE COMMISSION First Respondent
	CAVALIER WOOL HOLDINGS LIMITED Second Respondent
	NEW ZEALAND WOOL SERVICES INTERNATIONAL LIMITED Third Respondent

Hearing: 4 - 8 April 2016

Court: Gilbert J
Professor Martin Richardson, Lay Member

Counsel: J C L Dixon and S D J Peart for Appellant
M Dunning QC, N F Flanagan and E Rutherford for First Respondent
D J Goddard QC, S J P Ladd and J Q Wilson for Second and Third Respondents

Judgment: 13 June 2016

JUDGMENT OF GILBERT J

This judgment is delivered by me on 13 June 2016 at 3 pm pursuant to r 11.5 of the High Court Rules.

Registrar / Deputy Registrar

Solicitors:
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Introduction

[1] Godfrey Hirst appeals against the Commerce Commission's determination dated 12 November 2015 granting Cavalier Wool Holdings Ltd (Cavalier) authorisation pursuant to s 67(3)(b) of the Commerce Act 1986 to acquire control over the wool scouring business and assets of New Zealand Wool Services International Ltd (NZWSI).[1] Cavalier and NZWSI are the only providers of wool scouring services in New Zealand so the proposed acquisition will create a domestic monopoly for such services.

[2] The acquisition will enable the rationalisation of the Cavalier and NZWSI scouring operations from five to two, one in the North Island and one in the South Island. NZWSI's South Island scour lines situated at Kaputone near Christchurch will be relocated to Cavalier's South Island operation at Timaru. Similarly, NZWSI's North Island scour lines at Whakatu, Hawkes Bay, will be relocated to Cavalier's facilities at Awatoto, also in Hawkes Bay. The merging parties will then sell the Kaputone and Whakatu properties and any surplus plant. Cavalier will decommission its scour line at Clive, Hawkes Bay, and sell the property.

[3] Godfrey Hirst is affected because, as a manufacturer of woollen carpets in New Zealand, it purchases scoured wool. The Commission considered that the acquisition would be likely to result in scouring price increases of between five and 25 per cent for Godfrey Hirst and between five and 15 per cent for wool destined for export. The Commission nevertheless considered that the benefits of the transaction were likely to exceed its detriments. It assessed the net present value of the likely net benefit over a five year period as being between $1.15 million and $23.48 million. Over a 10 year period, the Commission assessed the net present value of the likely net public benefit as ranging between negative $0.82 million and positive $34.33 million.

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[1] *Cavalier Wool Holdings Ltd and New Zealand Wool Services International Ltd* [2015] NZCC 31 (Final Determination).

[4] Godfrey Hirst appeals against the determination arguing that the Commission made three significant errors, any one of which it contends is sufficient to require that the authorisation be overturned:

(a) The Commission ought to have discounted the benefits of the acquisition that will accrue to the foreign shareholder of the merged entity, Lempriere (Australia) Pty Ltd. Forty five per cent of the merged entity will be owned by Lempriere and it will have an option to increase its shareholding to 72.5 per cent. Godfrey Hirst argues that the benefits that will flow to Lempriere from the acquisition are not benefits to the public in New Zealand and should have been disregarded.

(b) The Commission underestimated the likely price increases for scouring services for wool destined for export following the acquisition. Godfrey Hirst argues that the likely price increases will be in the range of 10 to 20 per cent, not five to 15 per cent as assessed by the Commission.

(c) The Commission overestimated the benefits because it is likely that NZWSI will relocate the Kaputone scour to Timaru whether or not the acquisition goes ahead.

[5] Cavalier argues that the case for authorisation is stronger than the Commission assessed and it supports the determination on the following grounds:

(a) The Commission overestimated the likely redundancy costs payable to employees on closure of the Kaputone plant.

(b) The Commission ought to have taken into account the closure of the Clive plant as a benefit of the transaction because there is a real chance that it will not close if the acquisition does not proceed.

[6] The parties disagree about the correct test to be applied to an application for authorisation under s 67. Godfrey Hirst contends that an authorisation can only be granted where the Commission is able to exclude the real chance that there will be no net public benefit. The Commission's analysis identified the prospect of a net public detriment over a 10 year period although it considered that there was "only a remote possibility that the values would align in such a way that, over the 10-year timeframe, the extremities near the lower bounds and upper bounds would be realised".[2] Godfrey Hirst accepts that if this analysis is correct, then authorisation could properly have been granted. However, Godfrey Hirst argues that if any one of its grounds of appeal succeeds, it will not be possible to exclude the real chance of a net public detriment and the authorisation could not stand.

[7] Cavalier and the Commission dispute this analysis. They argue that an authorisation can properly be granted even if there is a real chance that there will be a net detriment so long as the risk of this occurring is sufficiently outweighed by the likely benefit.

[8] The contest over the correct approach to an authorisation under s 67 will only need to be determined if one or more of the other grounds of appeal succeeds. We therefore consider the other grounds first.

Approach on appeal

[9] An appeal from a determination of the Commerce Commission under s 67 is by way of a re-hearing. The approach is as directed by the Supreme Court in *Austin, Nichols & Co Inc v Stichting Lodestar*.[3] The appellant has the onus of satisfying the Court that it should differ from the decision appealed from. The Court will not interfere unless it is persuaded that the decision is wrong. The Court must make its own assessment of the merits of the case even where this requires an assessment of fact and degree and involves a value judgment upon which reasonable minds may differ. The weight that should be attached to the Commission's conclusion on any particular issue is a matter for the Court's judgment. We bear in mind that the Commission is a specialist body with broad investigative powers and it undertook a

2 Final determination, at [633].
3 *Austin, Nichols & Co Inc v Stichting Lodestar* [2007] NZSC 103, [2008] 2 NZLR 141.

comprehensive investigation extending over a 12 month period. The Commission conducted numerous interviews with industry participants, obtained expert assistance, issued two draft determinations and considered submissions from interested parties before issuing its final determination. The Court may rightly hesitate before concluding that findings of fact and degree are wrong. Nevertheless, as Cooke P stated in *Telecom Corporation of New Zealand v Commerce Commission* "there can be no suggestion of rubber-stamping a decision simply because it represents the views of experts".[4]

Should the Commission have disregarded the benefits that will flow offshore to Lempriere?

The Commission's approach

[10] The Commission noted that the primary benefits of the acquisition will come from the rationalisation of the scouring operations from five sites to two. This will improve economies of scale and generate cost savings and will enable the Whakatu and Kaputone sites to be released for other uses.[5] The Commission found that the benefits from these productive efficiency gains will flow to the shareholders.[6] Given that 45 per cent of these benefits will go offshore to Lempriere (leaving aside its option to increase its shareholding following the acquisition), the Commission concluded that this proportion does not directly benefit the New Zealand public:

> [400] Consequently, as the benefits from these productive efficiency gains will flow to foreign shareholders, these are not direct public benefits to New Zealand.

[11] However, the Commission relied on this Court's decision in *Telecom Corporation of New Zealand Ltd v Commerce Commission* (*AMPS-A*) in concluding that these gains to foreign shareholders should not be discounted:[7]

> [401] However, while focusing on shareholder residency may provide an accurate estimate of the immediate, direct benefits that arise within the market of interest, it is the Commission's view, following the Court's

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4 *Telecom Corporation of New Zealand v Commerce Commission* [1992] 3 NZLR 429 (CA) at 434.
5 Final determination, at [388].
6 At [395].
7 *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473 (HC).

> decision in AMPS-A, that this approach ignores other longer-term or wider public benefits.

[12] The Commission considered there were two offsetting "feedback" benefits such that the productive efficiency benefits should be recognised in their entirety:

> [404] The Commission considers that the productivity enhancements that would be obtained by [Cavalier] in terms of asset realisations and cost reductions should be included in the assessment of public benefits. This is despite the fact that some proportion of these gains would flow directly to foreign shareholders in the first instance. This approach, consistent with case law, recognises that enabling foreign shareholders to undertake such cost minimisation can provide significant flow-on benefits to New Zealand.
>
> [405] There are two main flow-on (feedback) benefits that are relevant in this case.
>
> [406] The first is that real cost savings brought about by the merger could ultimately enable the merged firm to better compete against international rivals. This may improve the likelihood that the domestic scouring sector would continue to operate profitably over the longer term. This could produce greater public benefits to New Zealand than may otherwise be the case if denying the merger would prevent the sector from undertaking beneficial cost rationalisation.
>
> …
>
> [411] The second reason to account for productivity efficiency gains flowing to foreign owners from a merger is that to do otherwise would effectively discriminate against such shareholders in comparison with domestic shareholders. Placing foreign owned businesses at a relative disadvantage in merger authorisations, would create a disincentive for foreigners to undertake investment into New Zealand more generally. Such a disincentive could be detrimental given the wider benefits that arise from inbound foreign investment. These benefits include a higher stock of available capital and lower cost of capital for the New Zealand economy, as well as improved technology and knowledge transfer.
>
> [footnotes omitted]

[13] The Commission recognised that these feedback benefits were unquantifiable and were unlikely to equate to the productive efficiency gains obtained by foreign shareholders from the merger. It nevertheless determined that the feedback benefits should be treated as offsetting the productive efficiency benefits flowing offshore to Lempriere:

> [415] Regarding the specific value of these feedback effects, the Commission acknowledges that the public benefits to New Zealand from these effects are unlikely to exactly equal the direct productive efficiency gains obtained by foreign shareholders from the merger. Although there is a

> real possibility that the benefits from these feedback impacts may be substantial, these effects may be unquantifiable. Nevertheless, because of the feedback effects identified, we do not consider it appropriate to exclude efficiency gains to foreign owners, consistent with the Court's view in AMPS-A.
>
> [416] Therefore, we do not consider that in this case there is a sufficiently strong rationale to depart from the approach that has been endorsed by the courts to date. For this reason, the following productive efficiency benefits have been estimated and these estimates included in their entirety.
>
> [footnotes omitted]

Submissions

[14] Mr Dixon argues that the Commission erred in adopting this approach. He contends that the Commission should have excluded from its quantitative analysis the proportion of productivity gains that will flow offshore to Lempriere. Because the feedback benefits are unquantifiable, he argues that the Commission should have considered them at the end of the exercise as part of its overall qualitative assessment. Mr Dixon submits that the feedback benefits bear no correlation to the productive efficiency gains flowing to foreign shareholders and the Commission was wrong in effectively equating them in its assessment. Mr Dixon further submits that the Commission's approach is not consistent with the authorities.

[15] Mr Goddard QC submits that the Commission reached the orthodox result on this issue, consistent with authority, but it used a novel approach that is wrong in principle to get there. He submits that when assessing the benefit to the public, the Commission is required by s 3A of the Act to have regard to all efficiency gains that are likely to result from the acquisition. As a matter of principle, a company that is incorporated in New Zealand and carries on business in New Zealand forms part of the general public and the general laws apply to it regardless of its ownership from time to time. Mr Goddard submits that there is no suggestion in Parts 2 or 3 of the Act that it is intended to distinguish between participants in New Zealand markets by reference to their nationality or ownership. For example, he notes that the purpose provision in s 1A refers to consumers "within New Zealand", being all consumers regardless of their nationality or ownership. Mr Goddard argues that this analysis is also confirmed by s 69A of the Act which makes clear that the Commission cannot

require an undertaking in relation to ownership of an applicant, or impose any such condition on the grant of an authorisation.

[16] Mr Goddard submits that all sorts of practical difficulties would arise if the Commission were required to consider the ownership of an acquirer: At what date would ownership be assessed? How would the Commission treat a publicly listed company where shareholdings may change frequently? Would the Commission need to consider the residency of shareholders of corporate shareholders? Would the Commission need to consider the residency of beneficiaries of trusts holding shares in an acquirer?

[17] Moreover, Mr Goddard submits that it has not been the Commission's practice since *AMPS-A* was decided in 1991, to discount efficiency gains achieved by New Zealand companies carrying on business in New Zealand merely because that company has a foreign shareholder. He submits that *AMPS-A* is authority for the proposition that benefits flowing to foreign shareholders should be disregarded and he says that this was the approach followed in *Air New Zealand v Commerce Commission (No 6)*.[8]

[18] Mr Dunning QC disagrees with both Mr Dixon and Mr Goddard in their respective interpretations of these authorities. He submits that the Commission's approach, differentiating between functionless monopoly rents (which should be excluded) and other benefits (which should not be excluded), is in accordance with the authorities.

[19] In summary, all three parties rely on the same authorities to support their fundamentally different contentions as to the correct approach to benefits accruing to foreign shareholders: Cavalier argues that these should be counted in every case; Godfrey Hirst argues that they should be disregarded in every case; and the Commission contends that it depends on the nature of the benefit.

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8 *Air New Zealand v Commerce Commission (No 6)* (2004) 11 TCLR 347 (HC).

Analysis

[20] There is a paucity of authority dealing with the issue of how to treat benefits to foreign shareholders. The leading authority is the decision of this Court in 1991 in *AMPS-A*. That case involved an application by Telecom for authorisation to acquire management rights to the AMPS-A radio frequency band for use for cellular telephone services in New Zealand. The Commission heavily discounted efficiency gains or cost savings that would accrue to Telecom from the acquisition because it was 80 per cent foreign owned. The High Court upheld the Commission's decision to decline authorisation but rejected its approach to the benefits accruing to foreign shareholders.

[21] Because all parties refer to *AMPS-A* to support their respective contentions as to the correct approach on the issue of returns to foreign shareholders, it is helpful to set out the Court's discussion of the issue in full:[9]

> We turn to consider a related issue that was raised by both Telecom and by counsel for the commission. This is how to treat the benefit to foreign shareholders versus the New Zealand public. The point arises from the commission's discounting of efficiency gains or cost savings to Telecom because "the bulk of the gain will be realised by Telecom's largely overseas owners". It did not disregard them but gave them weight "to only a minimal extent" (see Decision 254 paras 142 and 144(a)(vii)).
>
> The foundation for this view was the commission's finding that:
>
> "Since the most certain period for the realisation of these gains is the short-term future, and since the New Zealand shareholding in Telecom is likely to be a small minority during that period, the public benefit from the gains must be discounted accordingly".
>
> Telecom's evidence was that New Zealand ownership over the estimated relevant period was 20 percent though that was said to be conservative. There was no suggestion to us that any other estimate should be taken into account. That is a small minority.
>
> The issue of principle is whether efficiency gains and cost savings accruing solely to foreign shareholders are necessarily to be ignored as public benefits or at least to be largely discounted. It is to be observed that the commission did not disregard, in this connection, any gains and savings accruing potentially to New Zealand consumers, suppliers, and employees.
>
> The Act has an express New Zealand orientation. Both the long title and the definition of "market" refer to New Zealand and there is, on the other hand, distinct provision about Australia; s 26A(a), (b) and (c).

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9 *Telecom Corporation of New Zealand Ltd v Commerce Commission,* above n 7, at 531.

> Decisions as to dominance, its acquisition, and strengthening, are thus limited to the relevant market in New Zealand. Public detriment, which includes the result of the dominance or its strengthening, to that extent is limited to New Zealand results. Moreover, any inquiry and weighing of public detriment or public benefit beyond New Zealand would be difficult, problematic and unlikely to be of any meaningful benefit.
>
> Nevertheless, what redounds to the benefit of New Zealand society is not necessarily immediately obvious. We reject any view that profits earned by overseas investment in this country are necessarily to be regarded as a drain on New Zealand. New Zealand seeks to be a member of a liberal multilateral trading and investment community. Consistent with this stance, we observe that improvements in international efficiency create gains from trade and investment which, from a long-run perspective, benefit the New Zealand public.
>
> On the other hand, if there are circumstances in which the exercise of market power gives rise to functionless monopoly rents, supranormal profits that arise neither from cost savings nor from innovation, and which accrue to overseas shareholders, we think it right to regard these as an exploitation of the New Zealand community and to be counted as a detriment to the New Zealand public.
>
> While this approach to benefit to foreign investors can, we think, be justified on quite general and fundamental grounds, its appropriateness is reinforced by the insertion of s 3A into the Commerce Act.

[22] Section 3A of the Act provides:

> **3A Commission to consider efficiency**
>
> Where the Commission is required under this Act to determine whether or not, or the extent to which, conduct will result, or will be likely to result, in a benefit to the public, the Commission shall have regard to any efficiencies that the Commission considers will result, or will be likely to result, from that conduct.

[23] We do not consider that the reference in this section to *any* efficiencies that the Commission considers will result, or will be likely to result, means that the Commission is obliged to disregard any consequent supra-competitive returns to foreign shareholders. This section was inserted to counter any suggestion that might be taken from the reference to "the long-term benefit of consumers within New Zealand" in the purpose section of the Act (s 1A), that public benefits are confined to direct consumer welfare.

[24] Despite rejecting the Commission's approach of discounting benefits to foreign shareholders, the High Court in *AMPS-A* concluded that the detriments outweighed the benefits and accordingly upheld the Commission's decision:[10]

> Thus in this instance both benefits and detriments are almost entirely efficiency gains and losses. We endorse the commission's conclusion that the competitive detriments from the strengthening of dominance in this market outweigh any public benefit flowing from the acquisition.
>
> Although we have rejected the commission's discounting of benefits by reason of their overseas character, we find this an easy conclusion to reach. On the side of detriment to the public are all those likelihoods of allocative and dynamic inefficiency that we have discussed, a much larger set than those considered by the commission. On the side of benefit to the public are the likelihoods of some production or technical efficiencies, discounted however by the reason of the likelihood of an enhanced propensity to internal inefficiency on the part of Telecom by reason of the strengthening of its dominance.

[25] The High Court's decision was reversed by a full court of the Court of Appeal which unanimously concluded that the public benefits outweighed the detriments and that Telecom should be authorised to acquire the AMPS-A management right.[11] However, despite the decision being reversed, the High Court's approach to benefits accruing to foreign shareholders does not appear to have been challenged by any of the parties and is not criticised in any of the five judgments. For the reasons that follow, we consider that it is safe to assume that, had there been any disagreement with the approach taken to this issue in the High Court, it would have been addressed.

[26] Cooke P quoted the passages from the High Court judgment set out at [24] above confirming the Court's rejection of the Commission's approach in discounting benefits to foreign shareholders. His only expressed disagreement with what the High Court said in those passages was the suggestion that the balancing exercise was easy on the facts of that case:[12]

> What is required by the legislation is a balancing exercise, a comparison between likely public benefit from the acquisition and likely public detriment from the strengthening of Telecom's dominant position in either market. In respectful disagreement with what was said by the High Court in

[10] *Telecom Corporation of New Zealand Ltd v Commerce Commission*, above n 7, at 534.
[11] *Telecom Corporation of New Zealand Ltd v Commerce Commission*, above n 4.
[12] *Telecom Corporation of New Zealand Ltd v Commerce Commission*, above n 4, at 435. McKay J stated at 449 that he shared Cooke P's view that the balancing exercise was not an easy one on the facts of that case.

> the course of the passage about to be quoted, I do not find the exercise at all easy.

[27] Cooke P noted that the expert retained by Telecom, Dr A E Bollard, estimated "the economies of scope and scale which would arise from Telecom rather than a competitor managing AMPS-A as well as AMPS-B and spreading its overheads across a larger business base … together with improved returns to the shareholders at a broad value of about $100 million." Although Cooke P stated that he was sceptical of the accuracy of such estimates, he accepted that "there can be no doubt that some significant economies are likely". Despite the significant economies and consequent return to shareholders, there is no indication in any of the judgments that the Court applied any discount to these benefits on account of the 80 per cent foreign shareholding. If the benefits accruing to Telecom's foreign shareholders should have been discounted contrary to the approach taken in the High Court, this would have required special attention by the Court of Appeal as part of what it regarded as a difficult balancing exercise.

[28] We reject Mr Dixon's submission that the High Court's decision in *AMPS-A* was implicitly overruled by the Court of Appeal. Mr Dixon relies on the following observations made by Richardson J at the conclusion of his judgment:[13]

> The second is that both the commission and the Court accepted that the relevant benefits and detriments were almost entirely efficiency gains and losses. In these circumstances the balancing process does not give rise to the obvious problems of quantifying and then weighing disparate public interest considerations.
>
> The third is the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do so. The commission encourages applicants to quantify anticipated public benefits. In this case certain major efficiency gains were quantified for Telecom at some $75 million. While both the commission and the Court did not accept elements in that quantification, both bodies considered that there would be significant efficiency gains if Telecom had management rights over both AMPS-A and AMPS-B. In those circumstances there is in my view a responsibility on a regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.

[29] This observation was made in the context of the Commission's conclusion that the significant economies that had been quantified in the expert evidence led by

[13] *Telecom Corporation of New Zealand Ltd v Commerce Commission*, above n 7, at 446-447.

Telecom should be discounted because of "the likelihood of an enhanced propensity to internal inefficiency on the part of Telecom by reason of the strengthening of its dominance". Richardson J's criticism was that the Commission should have attempted to quantify these inefficiencies rather than relying solely on intuition.

[30] If Mr Dixon is correct that returns to foreign shareholders must be quantified and excluded from the assessment of public benefit and any offsetting feedback benefits factored in at the end of the process as part of the qualitative assessment, that exercise would have been undertaken by the Court of Appeal in *AMPS-A*. The Court would then have faced the problem of quantifying and weighing disparate public interest considerations. The fact that this was not done, coupled with Richardson J's observation that no quantification problems arose in that case, further supports the conclusion that the Court did not consider it appropriate to discount returns to foreign capital derived from efficiency gains and losses.

[31] We were advised from the bar that the Commission has consistently applied *AMPS-A* in all subsequent authorisation cases, as it was bound to do. The Commission's published guidelines refer to and adopt the approach set out in the *AMPS-A* decision.[14]

[32] The High Court's approach in *AMPS-A* was followed by this Court in *Air New Zealand v Commerce Commission (No 6)*.[15] That case concerned an application by Qantas to purchase 22.5 per cent of the voting equity capital of Air New Zealand and an interdependent application by Air New Zealand for authorisation of a proposed strategic alliance arrangement. No discount was applied to reflect the foreign shareholding in that case. The exercise that Mr Dixon submits is necessary in such cases, of quantifying and excluding the return to the foreign shareholder and then considering any feedback benefits as part of the qualitative assessment, was not undertaken.

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[14] See Commerce Commission *Authorisation Gjuidelines* (July 2013) at [53]-[55]. These Guidelines replaced the Commerce Commission's *Guidelines to the analysis of Public Benefits and Detriments* which were issued in 1994 and revised in December 1997.

[15] *Air New Zealand v Commerce Commission (No 6)*, above n 8.

[33] The Court's endorsement of the approach taken by the Commission in that case, consistent with *AMPS-A*, appears from the following passages in the judgment in *Air New Zealand*:

> [242] … Transfers between New Zealand and other countries are not necessarily regarded as welfare neutral.

We interpolate that this is consistent with the general rule set out in *AMPS-A* and the exception to it arising out of functionless monopoly rents.

> …
>
> [316] … the Commission agreed to ignore the capital payment to Air New Zealand from Qantas and as a corollary to disregard the share of Air New Zealand profits payable to Qantas for the purpose of calculating welfare losses.

This is consistent with the general rule in *AMPS-A*.

[34] The *AMPS-A* approach to returns to foreign shareholders was also followed by the Australian Competition Tribunal in *Qantas Airways Limited*.[16] After quoting the key passages from the High Court's decision in *AMPS-A*, the Tribunal stated:

> [198] We are guided by the treatment in the New Zealand jurisprudence of benefits accruing to foreign-owned corporations and their shareholders in the assessment of public benefits.
>
> [199] Accordingly, we concluded that, where we are satisfied that the Alliance would be likely to result in a lessening of competition, any associated supra-competitive returns likely to accrue to Qantas' foreign shareholders (due, for example, to higher fares or reduced capacity which, by definition, involve an income transfer from consumers, including Australian consumers), should not be regarded as a public benefit for the purposes of s 90. This would include any cost savings retained by Qantas for the benefit of its foreign shareholders which constituted such supra-competitive returns. (Similarly, any deadweight loss associated with higher fares or reduced capacity that accrues to Qantas' foreign shareholders should also be disregarded, as this does not constitute a detriment to the Australian public). However, we acknowledge that, in some circumstances returns to foreign shareholders of Australian companies may be re-invested in the Australian economy or might result in further foreign investment in Australia, in which case there would be a public benefit for the purposes of s 90.

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16 *Qantas Airways Limited* [2004] ACompT 9, [2004] ATPR 42-027, [2005] ATPR 42-065.

[35] While we understand that standard economic practice, as reflected in the Commission's practice before the *AMPS-A* decision, is to discount payments to foreigners in calculating domestic welfare, that *is* just practice and is not a fundamental economic principle or a necessary consequence of economic analysis. The statements of principle set out in the High Court's decision in *AMPS-A* concerning the treatment of returns to foreign shareholders were tacitly endorsed by a full court of the Court of Appeal and have since been followed both here and in Australia. It is now 25 years since the Court of Appeal's judgment in *AMPS-A* was delivered. We were not referred to any authority doubting its correctness. We expect that Parliament would have amended the Act if it was concerned that the statements of principle set out in *AMPS-A* were contrary to its intention, particularly given that these have been consistently applied by the Commission for the past 25 years in accordance with its published guidelines.

[36] It follows that we are unable to accept Mr Goddard's submission that foreign shareholding is to be disregarded in every case, even where the returns represent supra-competitive profits. We are also unable to accept Mr Dixon's submission that returns to foreign capital should be excluded in every case, even where these do not represent supra-competitive profits. We accept Mr Dunning's submission that, as a matter of principle, consistent with *AMPS-A* and subsequent authorities, any supra-competitive return to foreign capital should not be taken into account as a benefit to the public of New Zealand. We would add that it does not matter whether the supra-competitive return results from increased prices or efficiency gains. However, if the return on capital does not constitute a supra-competitive return but simply incentivises competitiveness, efficiency, innovation and investment, *AMPS-A* provides no justification for discounting that part of the return which accrues to foreign capital.

[37] The Commission concluded that production efficiencies would not give rise to functionless monopoly rents and accordingly did not discount them to reflect the foreign shareholding:

> [413] We consider that the domestic scouring sector faces a non-trivial competitive constraint from offshore scours and this competitive pressure may well increase over time. Furthermore, the degree of international

> transferability of scouring services and the ability for scouring activities to relocate to different countries, such as has occurred with the Australian scouring sector, means that without ongoing productivity improvements, ongoing competitive pressure could ultimately see the closure of the domestic scouring sector.
>
> [414] Therefore, we consider that productivity gains to the domestic scouring sector are unlikely to constitute functionless economic rents, at the very least over the medium to long-term.

[38] Godfrey Hirst does not challenge this finding. Accordingly, the Commission's treatment of returns to foreign shareholders from these productivity gains is consistent with long-standing authority and is correct.

[39] By contrast, the Commission discounted likely scouring price increases to the extent that these would flow to Cavalier's foreign shareholder.[17] This was because the Commission expects these price increases to be absorbed by New Zealand farmers and merchants thereby constituting a wealth transfer from New Zealanders to foreigners without any corresponding exchange of value as set by a competitive market. In short, the Commission regarded these likely price increases as being a functionless monopoly rent. This treatment is also consistent with the authorities.

[40] For the reasons given, this ground of appeal must fail.

Did the Commission underestimate the likely price increases?

[41] The Commission considered that the increased market power Cavalier would obtain as a result of the acquisition would enable it to raise scouring prices:

(a) by between five and 15 per cent for wool destined for export;

(b) by between five and 25 per cent for wool scoured for Godfrey Hirst; and

(c) by up to 10 per cent for wool grease sold to domestic consumers.[18]

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17 Final Determination at [607]-[624].
18 At [573].

[42] Godfrey Hirst challenges only the first of these assessments. It contends that the range of likely scouring price increase for wool destined for export would be more in the region of 10 to 20 per cent.

[43] Godfrey Hirst claims that the Commission reached its incorrect assessment as a result of two errors. First, the interviews conducted with merchants were deficient because the wrong questions were asked, in the wrong way, leading to speculative responses. Second, the Commission failed to analyse the responses correctly and overlooked or wrongly discounted evidence supporting higher price increases.

[44] Mr Dixon took us carefully through the particular passages in the various interviews which he contends support Godfrey Hirst's submission. He notes that in some instances, merchants were invited to engage in "crystal ball gazing" and "complete guesswork", even to the point of "throwing a dart at the dartboard". He submits that other questions were too imprecise to yield useful answers, for example when merchants were asked to comment on how they would be likely to react to a "whopping great price increase" or a "ridiculous price".

[45] While there is validity in these criticisms, the examples given are the product of Godfrey Hirst's careful scrutiny of the records and transcripts of all of the interviews conducted during the course of a lengthy investigation and are not representative of the interviews overall. Further, the questioning necessarily required merchants to speculate on how the market would be likely to react to price increases of varying levels. We see nothing wrong with the Commission seeking merchants' views about that.

[46] Even if there were shortcomings in the interview process, this does not materially assist Godfrey Hirst because the appeal is conducted on the record. This ground of appeal can only succeed if Godfrey Hirst can persuade the Court, based on the record, that the Commission's assessment was wrong.

[47] Mr Dixon accepts that there is ample evidence to support the range of price increases adopted by the Commission. However, he says that this is not the point. He argues that the Commission should have placed greater weight on the evidence of

the price increases the merchants said they could bear rather than their speculation as to what the monopoly scour might do. He contends that the evidence as to the former indicates that the price increase is likely to be more in the region of 10 to 20 per cent.

[48] We accept Mr Dixon's submission that there was evidence from a number of merchants that could support an inference that the price increase could be as high as 20 per cent. However, it does not follow that the Commission was wrong in reaching its assessment that the likely price increase will be lower.

[49] The Commission reached its conclusion about the likely price increases following an extensive investigative process. This included interviewing 13 out of a total of approximately 35 buyers of scouring services in New Zealand who together account for [ ] per cent of all scoured wool purchased in New Zealand.[19] Initial interviews were conducted between November 2014 and March 2015. A further round of interviews took place in July 2015 and there were additional follow-up interviews in September 2015. Most merchants were interviewed at least twice, one was interviewed three times and another, four times. In all, the Commission conducted a total of 21 merchant interviews.

[50] When conducting these interviews the investigators acknowledged that the task of accurately predicting future price increases in the event of the acquisition proceeding was inherently difficult and speculative. The information gathered from the interviews was necessarily imperfect and suffered from obvious limitations. However, we are not persuaded that the Commission should have disregarded, or placed little weight on, the merchants' views on the likely price increase. Their views, as key market participants, are relevant and will have provided some assistance to the Commission in making its assessment.

[51] It must be kept in mind that the Commission conducts an investigation, not a court process limited by evidential rules. For the purposes of carrying out its functions under the Act, the Commission has been given broad powers to receive any statement, document or information that may assist its determination regardless of

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19 At [264].

whether it would be admissible in a court.[20] Interviews with market participants will be conducted with varying degrees of formality, depending on the circumstances. Almost inevitably, the Commission will receive information during the investigation process of varying quality.

[52] The Commission may attribute little or no weight to some of the information it gathers and place greater weight on other information that it considers to be more reliable. However, the Commission does not make its assessment simply by accepting or rejecting the speculative views of market participants or by collating the merchants' responses and determining the range of likely price increases accordingly. Rather, the Commission is required to exercise its own expert judgment. This will be based, not only on information gathered during the investigation, but on its own knowledge of the industry and the dynamics of the particular market or markets. The Commission's assessment need not necessarily coincide with the views expressed by market participants.

[53] The Commission has a good understanding of the relevant markets, not only as a result of its lengthy investigation for the purposes of the present application, but also as a result of its consideration of an earlier similar application in 2011.[21] The Commission considered that demand for clean wool from New Zealand is likely to continue to reduce over time because of the global shift in the manufacture of wool products to Asia, the increasing quantity and quality of scouring capacity in that region, and the growing substitution of synthetics for wool products, particularly by domestic carpet manufacturers.[22] The Commission noted that wool merchants operate on narrow margins and have limited ability to absorb price increases themselves.[23] The Commission considered that it is unlikely that merchants would be able to pass on any post acquisition increases in scouring prices downstream to wool users in export markets.[24] This is because wool scoured in New Zealand must compete in an international market with wool scoured in other countries as well as with other fibres, including synthetic fibres. The Commission also considered that

[20] Commerce Act 1986, s 99.
[21] *Cavalier Wool Holdings Ltd* [2011] NZ ComCom 12: Decision No 725.
[22] At [214].
[23] At [330].
[24] At [325] – [326].

any attempt to pass the price increase upstream to farmers would be constrained by competition from exporters of greasy wool.[25]

[54] The Commission concluded that Cavalier's ability to increase scouring prices following the acquisition would be constrained to a greater or lesser extent by: the ability of wool merchants to increase their exports of greasy wool for scouring overseas, particularly in China;[26] Cavalier's need to maintain volume in a declining industry;[27] the prospect of entry by a new scouring operator;[28] and the prospect of Godfrey Hirst shifting its wool manufacturing business offshore.[29] Godfrey Hirst does not challenge these contextual conclusions regarding the dynamics of the relevant markets.

[55] The Commission assumed that the maximum price increase of 15 per cent would occur immediately after the acquisition.[30] However, it considered that this was a conservative approach that was likely to over-estimate the detriments because post-merger price increases at the upper end of the scale were likely to be imposed in incremental steps over time and not as an "immediate, one-off substantial increase".[31] The Commission also paired the highest chosen demand elasticity of -1 with the highest prospective price change when assessing the likely detriment. This was also a conservative approach, tending to over-estimate the likely detriment if anything.

[56] Taking all of these matters into account, we are not persuaded that the Commission's expert judgment, in adopting a range of likely price increases for wool destined for export of five to 15 per cent, was wrong. This ground of appeal also fails.

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25 At [331].
26 At [332].
27 At [287].
28 At [223] – [224].
29 At [574].
30 At [581].
31 At [283], [581] and [582].

Should the Commission have disregarded the benefits from closing Kaputone?

[57] In its first draft determination, the Commission accepted that if the acquisition did not proceed, the parties would continue to operate their existing businesses separately. Godfrey Hirst responded by suggesting that the Commission should consider another likely counterfactual, that Cavalier would close Clive and NZWSI would close its South Island operation at Kaputone and consolidate its operations in the North Island. Following further investigation, the Commission accepted Godfrey Hirst's submission in relation to Clive and disregarded the benefits of closing that plant on the basis that it was likely to happen whether or not the merger proceeded. However, the Commission found that Kaputone was not likely to close unless the acquisition proceeded and accordingly did not exclude these benefits.

[58] Godfrey Hirst does not challenge the Commission's conclusion that NZWSI is likely to continue its South Island operation if the acquisition does not go ahead. However, it now submits that the Commission ought to have considered another counterfactual, where the Kaputone operation is not closed but, instead, is relocated to Timaru.

[59] This suggested counterfactual was not promoted to the Commission by Godfrey Hirst or any other party. Nevertheless, we do not accept the submissions advanced on behalf of Cavalier and the Commission that this precludes consideration of the issue on this appeal. It is the Commission's responsibility to identify the relevant counterfactuals against which to assess the application. If it could be demonstrated from the record that the Commission failed to do so, this would be a judicially reviewable error and would be amenable to correction on appeal. Mr Goddard and Mr Dunning retreated from their written submissions on this point and did not seriously contend that the Court could not consider the issue in the context of an appeal so long as the error was apparent on the face of the record. However, they argue that the Court should have no difficulty concluding that this counterfactual is not supported by the evidence and that explains why the Commission did not consider it and no one pursued it.

[60] The Commission found that over the next two to three years, additional capital expenditure of at least [ ] would be required to [ ] and an additional [ ] to [ ]. Mr Dixon argues that in these circumstances there is a compelling business case to support relocating the Kaputone operation to Timaru. This would avoid the [ ] at Kaputone and the [ ], assessed by the Commission at between [ ] per annum. It would also enable the land at Kaputone, now zoned residential, to be released for a higher value use, leaving NZWSI free to purchase land at lower cost in Timaru. In the light of these savings, and given the planned move to Timaru if the acquisition proceeds, Mr Dixon contends that the Commission ought to have identified and considered this as a likely counterfactual even though Godfrey Hirst and its experts did not.

[61] Mr Dixon's submission confronts the immediate difficulty that there is no evidence that NZWSI gave any consideration to the possibility of relocating the plant at Kaputone to Timaru, or anywhere else, prior to the proposed acquisition. To the contrary, the evidence strongly supports the Commission's conclusion that if the acquisition does not proceed, NZWSI will upgrade its existing operation at Kaputone rather than close it down and set up somewhere else.

[62] In 2013, prior to considering the proposed acquisition, [ ] at Kaputone. [ ] per annum and NZWSI expected that it would [ ] of completing the necessary upgrades.

[63] Before reaching its factual findings regarding Kaputone, the Commission thoroughly tested NZWSI's claims concerning the proposed upgrade. It engaged independent experts to report on the necessity, viability and cost of the proposed solution and to consider whether there were any other more cost effective solutions. The Commission was advised that NZWSI's proposal was technically viable, no better solutions were available and it was satisfied that the increased profitability resulting from the [ ] would justify the investment.[32]

[64] In summary, there is ample evidence to support the Commission's finding that NZWSI will upgrade Kaputone and continue its operations there if authorisation

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[32] Final determination at [146].

is not granted. In the absence of any evidence to show that NZWSI was even remotely considering the possibility of establishing a new operation at Timaru instead of upgrading its existing operation, we consider that the Commission cannot be criticised for not examining this possibility. It had not been heralded in either of the earlier draft determinations, had not been raised by anyone during the course of the 12 month investigation and was not supported by the evidence. The Commission could not have found that there was a real chance of this scenario occurring without referring the matter back to the parties for further submissions. It must be kept in mind that the entire authorisation process is normally expected to be completed within 60 working days.[33] This indicates that the Commission is not required to chase down every conceivable possibility, irrespective of whether it has been considered by the applicant or identified by any other party.

[65] For the reasons we have given, we are not persuaded that the Commission was wrong in not finding that there is a real chance that NZWSI will close Kaputone and establish a new operation at Timaru if the acquisition does not proceed. This ground of appeal also fails.

[66] The appeal must accordingly be dismissed and it is therefore not necessary for us to consider the grounds raised by Cavalier to support the determination on other grounds. However, in case the matter goes further, we briefly do so.

Did the Commission overestimate the likely redundancy costs at Kaputone?

[67] There is no dispute that the Commission overestimated the likely redundancy costs at Kaputone. The correct figure based on Cavalier's evidence is [ ], not [ ] as assessed by the Commission.

Was the Commission correct to disregard the benefits of closing Clive?

[68] The Commission identified two counterfactual scenarios regarding the Clive plant:

> 141 Based on the information provided by Cavalier discussed above, we consider that there is more than one likely without-the-acquisition scenario regarding Clive.

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33 Commerce Act 1986, s 67(3).

141.1 There is a real chance that without the merger Cavalier would retain its scouring plant in Clive and continue to run it in peak periods.

141.2 There is also a real chance that, without the merger, Cavalier would close or sell the Clive site in the near future.

[69] In accordance with its interpretation of the High Court's decision in *Woolworths & Ors v Commerce Commission*, the Commission conducted its analysis on the basis of the closure scenario giving rise to the most acute competition concern.[34] The Commission therefore excluded all benefits of closing Clive from its analysis. These benefits were assessed as being in the range from [ ].

[70] Mr Goddard submits that the Commission misapplied *Woolworths* because that was a clearance case decided under s 66 of the Act where an applicant is required to satisfy the Commission that there will not be any substantial lessening of competition, comparing the factual against all counterfactuals. In that context, it is appropriate to consider the counterfactual giving rise to the most acute competition concerns because the Commission must be satisfied that a substantial lessening of competition is not likely.[35] If the Commission is not satisfied of this, it must decline clearance. By contrast, in assessing an application for an authorisation, Mr Goddard submits that the Commission is obliged to consider all benefits and detriments that have a real chance of occurring and weigh these by taking into account the likelihood of their occurrence and the reliability of the quantification. Accordingly, he submits that the Commission ought to have taken into account the increased probability that Clive will be closed if the acquisition proceeds; a certainty that it will close in the factual compared with a real chance, but less than a certainty, that it will close in the counterfactual.

[71] Only efficiency gains that are merger-specific can be considered. If the posited efficiency gain can be achieved without the merger and is likely to occur anyway, it does not qualify for consideration.

[72] The evidence shows that Clive has had [ ].[36] [ ] and has accounted for only [ ] per cent of Cavalier's North Island volumes over the

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[34] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [122].

[35] *Commerce Commission v Woolworths Ltd* [2008] NZCA 276, (2008) 12 TCLR 194 (CA) at 207.

[36] The Commission released its final determination on 12 November 2015 and recorded that Clive had [ ].

past four years. While the Commission accepted that there was a chance that Clive would be retained if the acquisition did not proceed to cover any peak season capacity constraints and annual maintenance shutdowns at Awatoto, its closure is not a merger-specific benefit in the required sense. The efficiency gains available from closing Clive can be achieved without the merger and Cavalier has deferred consideration of whether it will do so until after the result of this authorisation application has been finally determined.

[73] We are not persuaded that the Commission was wrong to disregard the claimed benefits of closing Clive.

Result

[74] The appeal is dismissed.

[75] All parties agree that this is a category 3 case for costs purposes. It is categorised accordingly. If the parties are unable to agree the issue of costs, sequential memoranda should be filed.

M A Gilbert J

Addendum

[76] The unredacted version of this judgment was released to counsel and their solicitors on 8 June 2016 to enable them to advise those parts of the judgment which ought to be redacted from the public version of the judgment on grounds of confidentiality and commercial sensitivity.

[77] Counsel have sought redaction on these grounds to parts of the following paragraphs in the judgment: paras [49], [60], [62], [63], [67], [69], [72].

[78] I am satisfied that these redactions should made to the judgment for reasons of confidentiality and commercial sensitivity.

[79] The judgment with these redactions may now be released and published.