

Memorandum

Date: 31 August 2015
To: The Chairman and Members
Commerce Commission

FROM: Grant David
DIRECT: +64 4 498 4908
MOBILE: +64 27 4410 322
FAX: +64 4 472 7111
EMAIL: grant.david@chapmantripp.com
REF: 100136427/2388436.3

By email

CAVALIER WOOL HOLDINGS AND NEW ZEALAND WOOL SERVICES INTERNATIONAL - GODFREY HIRST SUBMISSION FOR CONFERENCE ON PROPERTY VALUATIONS

Introduction and summary

- 1 On behalf of Godfrey Hirst (NZ) Limited (Godfrey Hirst), we present this submission for the Commission Conference on Property Valuations rescheduled for 1 September 2015.
- 2 In advance of that conference, we consider it important that the Commission take into account the following procedural issues and concerns:
 - 2.1 Godfrey Hirst goes into the conference under a substantial disability because of the significant information asymmetry between Godfrey Hirst and CWH.
[REDACTED]
 - 2.2 Godfrey Hirst also go into the conference under an additional disability because [REDACTED]
 - 2.3 More generally, as previously expressed to the Commission, it is poor process to go into the conference without the parties being aware of the Commission's initial views on the valuations. The submissions that the Commission has called for are necessarily to be provided in a vacuum, rather than in response to a position taken by the Commission. The better approach would be for the Commission to have issued a revised draft determination to take into account this new information (as well as all the other new information, [REDACTED])

3 We submit below that the only proper way ahead now is for the Commission to issue a revised draft determination which does take account of all that new information and indicate the Commission's thinking on all matters, including property valuations.

4 Those procedural issues aside, in this submission we say the Commission should:

4.1 Adopt the property valuations provided by its own properly qualified and properly instructed valuers, Knight Frank and Turley & Co, who have provided "best practice" valuations;

4.2 [REDACTED]

4.3 [REDACTED]

4.4 Have regard to the alternative counterfactuals (being the sale of the Kaputone and Clive sites without the CWH/NZWSI merger proceeding), [REDACTED]

Procedural concerns

5 The information asymmetry that afflicts us is mostly of the Commission's making. We repeat our protests at the extensive confidentiality which the Commission has imposed on us in terms of its interpretation of our confidentiality undertakings, in relation to much of the information to be considered at the conference. Indeed, not only is the conference itself closed to the public, but we are unable even to inform our client of the contents of the confidential topic list which has been circulated to participants.

6 Of particular concern, is the [REDACTED]

[REDACTED]

...

[REDACTED]

7 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] CWH's current application to the Commission seeking authorisation to acquire NZWSI and Lempriere's previous application to the OIO. The non-public nature of any information held by any organisation that is subject to the Official Information Act does not of itself override the primary principle of availability.

8 Second, the Commission's acceptance [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

9 There are a number of further responses that we could make to the Commission's reasons, but for present purposes, our paramount concern is the procedural unfairness it results to Godfrey Hirst from the Commission having adopted such a "closed material procedure". The obvious shortcomings of a closed material procedure are discussed in the decision of the UK Competition Appeal Tribunal in *BMI Healthcare (and others) v Competition Commission*. The Tribunal noted (at para 42):

The point about a closed material procedure is not that material is withheld, but that the persons able to look at such material are circumscribed. At its most extreme, a closed material procedure involves an advocate acting for an affected party in court proceedings, but in circumstances where, once that advocate has seen the "closed" material, he or she is precluded from taking instructions from the affected party.

10 Such procedure is described by the Tribunal as "a derogation from the principle of natural justice".

11 The Commission's suggestion that it will "test the information", and that this should be "sufficient for your purposes", does not properly reflect the procedural rights of affected third parties under the Commerce Act and the common law. First, affected third parties are *entitled* to participate and – critically – to test the arguments and information advanced by the applicant. Our role is not limited to scrutinising the Commission's analysis.

12 Second, the principle of availability in the Official Information Act reflects a policy recognition that agency decision-making is improved by public involvement. Our client, as a leader in the sector, is uniquely qualified to assess the arguments and information that the applicant relies upon. But we are denied the ability to discuss these matters with our client, let alone represent its views to the Commission. In short, the Commission's approach derogates significantly from accepted principles of natural justice.

13 That derogation is exacerbated here by the fact that exclusion from confidential material has been one sided. To elaborate, counsel who have been representing the applicant CWH throughout the authorisation process, Bell Gully, are now also

representing Lempriere/NZWSI. This was confirmed to us in the Commission's email (Mya Nguyen) of 25 August 2015.

14 In her email, Ms Nguyen also advised that:

[REDACTED]

15 We appreciate of course [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

16 On that basis, there are no grounds for [REDACTED]
[REDACTED]
[REDACTED]

17 But, in any event, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] The practical effect is that the Commission has imposed a closed material procedure on Godfrey Hirst, [REDACTED]
[REDACTED]

18 All this raises significant procedural issues, including but not limited to:

- [REDACTED]
[REDACTED]
- [REDACTED]
- [REDACTED]
[REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]

19 At the very least, procedural fairness requires that the Commission [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

20 In addition, to the above procedural issue, there is important information [REDACTED]

[REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

• [REDACTED]

[REDACTED]

22 Bell Gully's submission of 10 August 2015 on behalf of both CWH and Lempriere/NZWSI states [REDACTED]:

[REDACTED]

23 The submission goes on to acknowledge [REDACTED]

24 The starting point is that Justice Mallon's words have been taken out of context. Specifically, [REDACTED] Rather, Godfrey Hirst had argued before Her Honour (at

279) that any public benefit can only arise if there were improved productivity from making surplus land available. Justice Mallon disagreed; and ruled that the public benefit is that fewer land and building resources are needed for scouring operations in the factual compared to the counterfactual, thereby releasing land for other productive uses. Her Honour stated (at 281):

It is not necessary to inquire into the relative level of productivity of the alternative use. The benefit lies in the release of surplus resources for other economic uses; and the best evidence of the value of those alternative uses is to the price that is likely to be paid for the surplus resources.

25 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] Her Honour notes (at 276) that the Commission concluded:

All valuations are to some degree subjective, it is not until the sale is made that the true value is revealed.

26 Similarly, at 286, Her Honour states:

As the Commission recognise, the true value is what someone paid in a sale.

27 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

28 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

■ [REDACTED]

[REDACTED]

34

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

38

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

42 [REDACTED]

43 [REDACTED] the Commission's email (Mya Nguyen) to us of 16 June advising that the Commission had released its valuations to the respective property owners (being to Lempriere/NZWSI in the case of Kaputone) and authorising us to advise our own client as to the result of the valuations in the following terms:

1. *The Commission's valuations for each of the properties is lower than the valuations provided by Cavalier in the Application;*
2. *The issue of the valuations is potentially material in the Commission's final determination.*

44 [REDACTED]

45 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

52) Wool scouring is an inherently dirty and potentially hazardous operation [REDACTED] [REDACTED] The worst things in wool scour effluent are residual pesticides and non-recoverable wool grease, together with dirt which makes for a concentrated heavy waste stream. With the exception of Kaputone, each of the scours in New Zealand would have an effluent loading similar to a town of 20,000 people. Kaputone treats its effluent to a much higher standard so the discharge is not nearly as bad – that is, provided the treatment plant is operating properly and there is no spillage.

53) In terms of other chemicals, there are 2 types of detergent used for wool scouring: 9mol detergents which have phenols that are bad for the environment and have been banned in Europe (but they are cheap); and 6mol detergents which are the

alternative but they are more expensive and more is needed to wash the same volume of wool. New Zealand scours generally use a mix of both detergents because some end users and countries require the 6mol processing. Other common chemicals used in scouring include hydrochloric or sulphur and hydrogen peroxide.

54 There are also uncommon chemical treatments using a range of noxious chemicals at the end user's request, such as mothproofing and fire retardants.

55 A full description of the [REDACTED] is set out in the report by [REDACTED] which was attached as an Appendix to Godfrey Hirst's Post Conference Submission of 23 June.

56 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

57 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

58 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

60 [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

61 [REDACTED]

[REDACTED]

63 [REDACTED]

[REDACTED]

Counterfactual

65 [REDACTED]

[REDACTED]

67 [REDACTED]

68 [REDACTED]

[REDACTED]

69 [REDACTED]

70 [REDACTED]

71 As Professor Guthrie shows, in the Economist’s Report attached to Godfrey Hirst’s Final Submission, if the scour at Kaputone were to be closed unilaterally by Lempriere/NZWSI this would give Lempriere an immediate lump sum gain of [REDACTED] million. It would lose future annual cash inflows, currently estimated to be [REDACTED] million (pre tax), but those inflows are likely to fall in any event as the wool clip declines further. Besides, NZWSI could divert wool to its remaining North Island scour; or utilise the services of the Chinese scours which the Applicant propounds for other users.

72 All that must represent a very attractive prospect for Lempriere/NZWSI.

73 [REDACTED]

74 Certainly, the longer the authorisation process – and any potential appeal against the Commission’s determination – takes, the greater that risk, presumably.

75 Commercial common sense would see Lempriere/NZWSI want to mitigate that risk by bringing forward completion. It has the means of doing so: [REDACTED]

- 76 Of course, all this scenario unfolds *without* the CWH/NZWSI acquisition. It is a highly plausible alternative to the status quo counterfactual. And, as Professor Guthrie has demonstrated in his Economist's Report, the effect must be that the benefits of the proposed CWH/NZWSI acquisition as calculated in the draft determination should be reduced by [REDACTED]. If subsequent information is used, the net benefit should instead be reduced by [REDACTED].
- 77 Similarly, the prospect of Cavalier needing unilaterally to close and divest its under-utilised Clive scour (as outlined in paragraphs 8 to 38 of Godfrey Hirst's Final Submission) has just substantially increased. On Friday 28 August Cavalier Corporation reported the worst loss in its history, posting a loss of \$25.7 million, or 37.4 cents per share, in the 12 months ended June 30, from a profit of \$5.8 million, or 8.5 cents, the year earlier. The result, the company's worst since it listed in 1984, includes \$24.4 million of asset write-downs and almost \$1 million of restructuring costs. Cavalier's announcement is attached as Appendix F.
- 78 As was shown in Godfrey Hirst's Final Submission, Cavalier, whose shares have lost more than half their value the past year, has changed its chief executive and chairman and rejuvenated its board in an attempt to restructure the business. The company is currently looking at asset sales, job cuts and outsourcing to try and return to profit. It plans to sell its Australian Ontera Modular Carpets unit to release \$6.5 million to reduce debt.
- 79 Cavalier's last desperate attempt at transformation must now include procuring the sale of assets like the Clive scour. Again, such divestment of the Clive scour would occur *without* the CWH/NZWSI acquisition.
- 80 After last Friday's announcement that is an even more plausible alternative to the Commission's status quo counterfactual.

Valuations

- 81 The Commission has before it a number of valuations, and commentaries on valuations, of the NZWSI's sites at Whakatu and Kaputone and Cavalier's site at Clive. Because of the narrow net public benefit margin of \$2.51 million indicated in the draft determination, as the Commission has indicated:

The issue of valuations is potentially material in the Commission's final determination.

- 82 That understates the position: the issue of the valuations of the three surplus sites – and the public benefits attributable to their becoming available for other uses - is likely to be determinative of the Application.
- 83 For that reason, the Commission has properly appointed its own independent expert valuers to consider those sites; and again, properly sought commentary from the Applicant and other parties on the Commission's valuers' considered valuations.
- 84 To outline the valuation saga more fully, Chapman Tripp received a copy of the Applicants' "recent third party valuations" referred to in paragraph 334 of the draft determination on 16 March. We criticised these valuations in Godfrey Hirst's Submission on the Commission's Draft Determination, and provided an

accompanying Valuer's Report from Wayne Nyberg of Darroch. The Applicant's valuations in fact had been prepared in early to mid 2014 for CWH's proposed financial and accounting purposes. There was no indication in the Applicant's valuations of the impact of the proposed covenants to be put on the sites, and therefore an alternative use approach was needed.

85 [REDACTED]

86 The Commission then instructed independent valuers, Knight Frank and Turley & Co., to undertake up-to-date and independent valuations of all the properties. On 11 June the Commission provided their resulting valuations to Chapman Tripp and CWH and NZWSI for review and comment.

87 Chapman Tripp and Mr Nyberg supplied comment on the Commission's valuations in Godfrey Hirst's Post Conference Submission dated 23 June. We said the valuations undertaken by Knight Frank and Turley & Co. for the Commission were examples of "best practise valuations" and the methods used are utilised correctly in order to ascertain the most probable competitive price prediction to give accurate market valuations.

88 We did point out however that [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] we suggested that the Commission make allowance for such uncertainty by allowing for a downwards margin.

89 The Commission also received detailed criticism and comment on the Knight Frank and Turley & Co valuations on behalf of CWH and NZWSI.





90 Chapman Tripp subsequently received reviews of the valuations and submissions on Clive, Whakatu and Kaputone sites which had been undertaken by Knight Frank and Turley & Co. In these reviews Knight Frank and Turley & Co stood by their original valuations and refuted all criticisms made on behalf of CWH and NZWSI.

91 Property valuation is a carefully controlled profession. The definition of "Market Value" as advocated by the New Zealand Institute of Valuers, is as follows:

Market Value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller and an arm's length-noted transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

92 As to the process, the Valuation and Property Standards (at 6.4) require:

The Valuation Process requires a Valuer to conduct adequate and relevant research, to perform competent analyses, and to draw informed and supportable judgments. In this process, valuers do not accept data without question but should consider all pertinent market evidence, trends, comparable transactions and other information. Where market data is limited, or essentially non-existent (as for example with certain specialised properties), the Valuer must make proper disclosure of the situation and must state whether the estimate is in any way limited by the inadequacy of data. All valuations required exercise of a Valuer's judgment, but reports should disclose whether the Valuer bases the Market Value estimate on market evidence, or whether the estimate is more heavily based on the Valuer's judgement because of the nature of the property and lack of comparable market data.

- 93 We submit that the valuations received by the Commission from Knight Frank and Turley & Co Limited fully accord with the valuation process as required. Further, Knight Frank and Turley & Co have received – and responded to – detailed criticism of their initial valuations by all interested parties. As a result of that process, neither Knight Frank nor Turley & Co has amended the Market Value that it attached to the relevant property.
- 94 What *has* happened is that, subsequent to that process, 



- 95 We submit that it would be dangerous for the Commission, having engaged and instructed its own expert valuers, who have demonstrably employed best practice, now to depart from the valuations that those experts have provided.
- 96 Notably, unlike in other aspects of its consideration of the application before it, the Commission itself is *not* expert in the skills and experience required to carry out market valuations in accordance with prescribed valuation process. While section 9(4) of the Commerce Act provides that a person must not be recommended for appointment as a Member of the Commission unless that person has knowledge and experience in industry, commerce, economics, law, accountancy, public administration or consumer affairs, there is no reference in the criteria for appointment to the Commission to any requirement that any Member of the Commission should have particular experience or expertise in property valuation. So far as we are aware, no Member is in fact so qualified.
- 97 Thus, the Commission in carrying out its functions under the Act necessarily is reliant upon its appointment of consultants who do have that requisite expertise and experience. Unless it can be shown that the Commission's appointed valuers have acted without reasonable care or in bad faith, the Commission should adopt the findings of its own experts.
- 98 Put bluntly, the Commission simply does not have the capacity to determine that its own appointed expert valuers are wrong, unless lack of reasonable care or bad faith can be demonstrated. The Commission has no reason to suppose that the

professional standards of its own advisors will be less than the standards which the law imposes upon Commission Members themselves.

99 Put another way, the Commission having properly instructed properly qualified valuers, and having provided a robust process whereby those valuers were exposed to the comments and criticism of all interested parties, the Commission should now adopt the valuations determined by its own experts.

100 It is subject only to the caveat that, given that [REDACTED]
[REDACTED]
[REDACTED], the Commission should allow for a downwards margin because of the enhanced contingency.

The proper way ahead

101 Although the Commission rejected Godfrey Hirst's suggestion that this conference be deferred until after [REDACTED]
[REDACTED] – we maintain our position that the Commission should not rush to issue its final determination following the conference on valuations. Rather, the proper way ahead is for the Commission to issue a revised draft determination, with opportunity for final comment by interested parties.

102 That has the benefit of avoiding some unsatisfactory potential outcomes, in what shapes as a very tight contest.

103 For example, if the Commission were, for argument's sake, [REDACTED]
[REDACTED]
[REDACTED] That would mean authorisation never should have been granted in the first place.

104 Such issues do not arise if the Commission takes additional time to issue a further draft determination. This case differs markedly from the ordinary issues with predictive modelling, where approval of an acquisition is premised on estimates that may ultimately not prove to be correct. Here, the Commission does not have to guess [REDACTED]
[REDACTED]

105 Of course, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

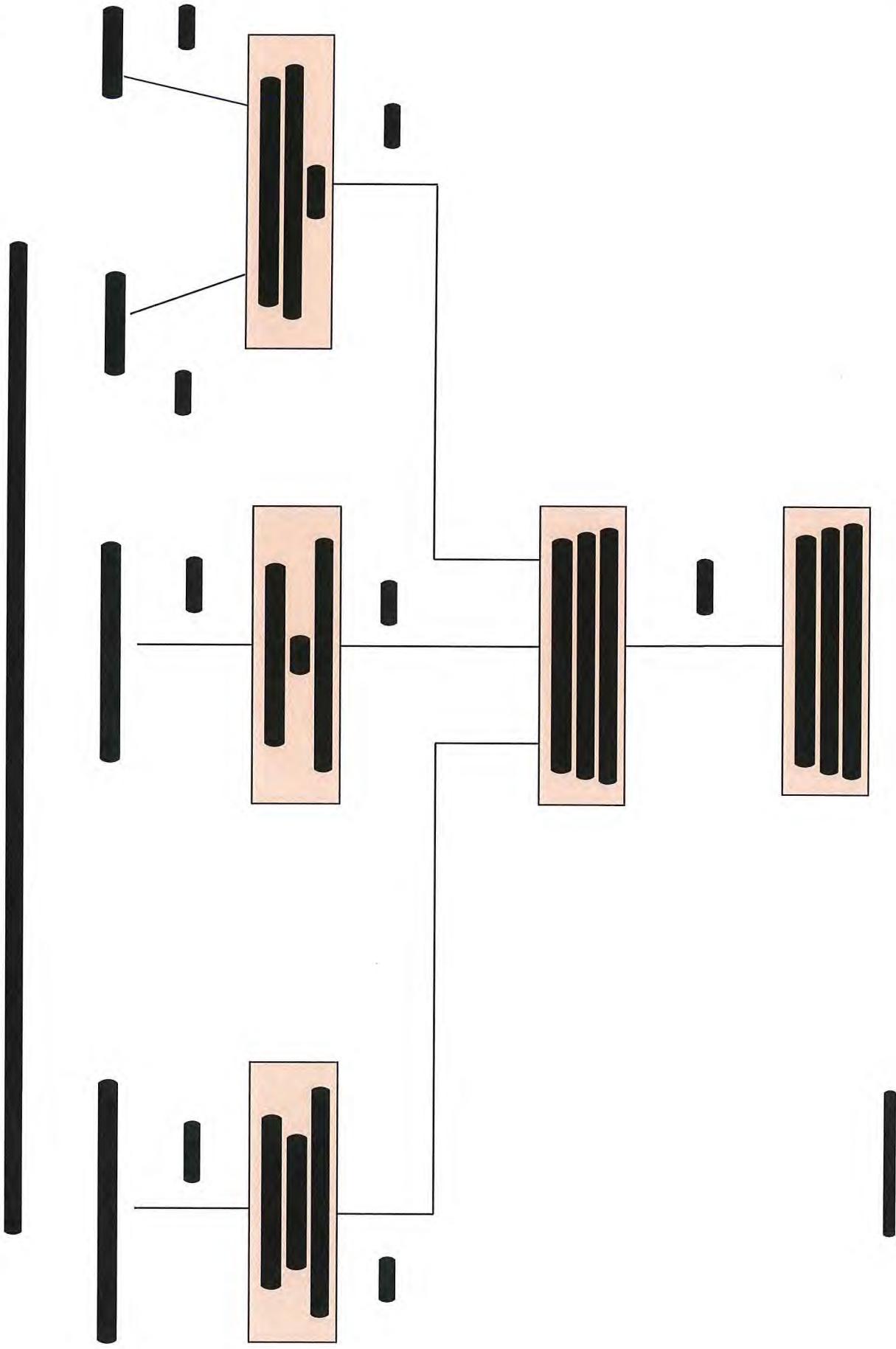
- 107) [REDACTED] Further, different potential occupiers of a particular site will have a different risk profile dependent upon the precise nature of their intended use for that site.
- 108 Pending any sale, the Commission can only attribute [REDACTED] the valuations attributed to those sites by its own expert valuers, Knight Frank and Turley & Co.
- 109 It should however allow a downwards margin for any contingencies those valuers were required to assume were not present. Application of such a margin would in no way detract from the overall credibility of those valuations.
- 110 Importantly, the Commission must also recognise that the alternative counterfactuals (i.e. to the status quo) as outlined in Godfrey Hirst's Final Submission now have been shown by recent events to be much more real. First, [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
- 111 Similarly, Cavalier Corporation's continuing and worsening predicament make its need to close and dispose of the Clive scour more pressing. Again, that sale could happen without the CWH/NZWSI acquisition.
- 112 For all those reasons, we urge the Commission, once it has considered the evidence and the submissions at the conference on valuations, to issue a revised draft determination that takes into account the [REDACTED] developments that have occurred, [REDACTED] in revised figures that have come to light, since the original draft determination was issued. It is only after the parties have made submissions on the revised draft that the Commission should proceed to issue a final determination.
- 113 While that will necessarily cause some delay, it is now the only proper way ahead for the Commission. Further, such delay will be of the Applicant's own making.

Grant David
CONSULTANT

DIRECT: +64 4 498 4908
EMAIL: grant.david@chapmantripp.com

Appendix A - 

Appendix B -



Appendix D - 

Appendix E - 

Appendix F – Cavalier Corporation’s announcement of 28 April 2015