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CROSS-SUBMISSION TO RESIDENTIAL BUILDING SUPPLIES MARKET STUDY (POST-CONFERENCE)

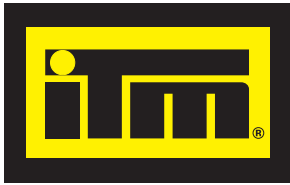
1. ITM is a leading nationwide merchant co-operative chain, comprising 91 independent building supplies stores operating under the umbrella of a co-operative structure and brand of “Independent Timber Merchants”.
2. ITM would like to thank the Commissioners and staff for their willingness to engage during the recent public Conference on the Draft Report held in Wellington over 27-29th September 2022.
3. We follow up with brief comments to amplify a few points discussed during the Conference, and to address some additional topics (such as potential remedies or recommended solutions) that were not fully canvassed due to time constraints at the Conference.
4. None of the comments below need to be marked *confidential*. If specific further detail is needed, we can meet confidentially with the Commission.

Regulatory systems and bureaucratic barriers to competition

5. The Commission heard plenty about these issues during day 1 of the Conference. Almost all participants in the building sector appear to be saying the same thing: that consenting, BCA, and other regulatory elements have had unintended consequences over time, and helped solidify existing market power around a few core/critical products.
6. ITM strongly endorses the need for the Commission to look at many problematic examples provided to this Market Study, including in our own Submission to the Draft Report. Regulatory hurdles to competition involves a complex set of issues, without a single bullet answer. We hope the Commission will examine the fullest set of potential changes and remedies, and lay out clear choices for MBIE to then consider and activate.
7. MBIE is the key agency given its role administering other aspects of building industry regulation, as well as competition policy. The Commission’s Final Report should urge MBIE to join up (or dismantle) those silos of regulation and make improvements to diminish market power in the building supplies sector.

Strategic Conduct and Vertical Market Power effects

8. This was addressed on day 2 of the Conference, but time was limited to fully traverse the effects of strategic conduct, and of what range of solutions might be recommended in the Final Report.
9. Vertical Integration is not in itself a problem. In some cases it enables effective cost minimisation through the supply chain, leading to more affordable homes. Or it may deliver better value to be added at levels within the supply chain (e.g. panelisation or prefabricated frame and truss operations, which drives improved productivity and higher quality).
10. But vertical market power can be problematic in some cases, especially when:



- it is used to strengthen or embed monopoly/duopoly market situations at the expense of other competitors or innovators in the market;
 - It is used to foreclose supply, or impact pricing or product availability through the supply chain - interfering with normal balance or market bargaining power tension.
11. The best and most recent example of the latter problem, input foreclosure or 'refusal to deal' exclusionary tactics, was the structural timber squeeze that came to the Commission's attention during 2020. After preliminary enquiries, the Commission declined to even open an investigation at that time, which was surprising. We speculate that may have been with one eye on the current Market Study arriving in due course, or it may have been because the current section 36 of the Commerce Act is effectively a dead letter of enforcement for the Commission.
 12. Whatever the reason, not even opening an investigation allowed CHH to exploit its refusal to deal stance for around 18 months now. We do recognise there is hope for the reformed s 36 law coming into force after April 2023. But any action will take a long time, first with drawn-out investigations and analysis of various theories of harm, then second with court enforcement measured in years not months, and prolonged probably by appeal rights too.
 13. So it is unrealistic to expect much clarity and real change in market dynamics from this alone. It will be easily another 18 months, or much longer, before the conglomerates felt their vertical market power under constraint in any realistic way.
 14. Notably, CHH attended the Conference remotely as observer, but refused to comment or participate even when invited by the Chair to do so. It is possible to infer a degree of confidence that its market power will not be meaningfully impacted at all by the Draft Report, from that surprisingly reserved stance.


A range of interim or innovative regulatory measures exists for consideration

15. We understand, or get the sense there is not appetite for dismantling current vertical integration or major imposition on private property rights built up over decades. ITM suggests that other steps could be usefully considered in the meantime, rather than pinning hope only on better court rulings that will take 'an eternity' in the life cycle of the construction sector.
16. We suggest the Commission assess a range of practical regulatory oversights and improvements, for implementation or enforcement by an independent market observer body or adjudicator if the Commission is not resourced for it – especially where vertical dominance is apparent.
17. Some forms of interventions aim for improved transparency of market supplies and market power, based on 'access-seeker' models in other fields of competition law. That would reflect the reality that in times of short supply, even large customers like ITM or Mitre 10 are at the mercy of the controllers of Gib Board, fibre cement, steel, or structural timber products. So an access-seeker regime is an appropriate analogy to consider, in the face of refusals to deal or foreclosure tactics.
18. Access remedies often arise from control of essential bottleneck facilities (sawmills perhaps) but in building suppliers context could be control of essential products by near monopoly producers.



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19. **Recommendation:** assess these options we can think of (noting the Commission and MBIE may have more in the toolkit as well), including:
- FRAND access terms (“fair, reasonable and non-discriminatory”) could be developed and mandated for product allocation of critical near monopoly products;
 - An Industry Code of Conduct, to operate in times of shortage, could be developed - with enforceable agreed allocation methods (based on market share, previous year ordering volumes, or some objective pro-rata metric);
 - Industry information disclosure and reporting requirements could be brought in, for data to be provided to the Commission (say, quarterly, on product supplies available and/or delivered and shared fairly amongst the 5 main merchants in the channel to builders – some regular sunlight and scrutiny of how they are being allocated would be at least a start;
 - Compulsory Mediation-Arbitration models could be developed in the event of supply/access disputes (in 2020 we faced a supplier of timber unwilling to talk, give reasons, reconsider or negotiate at all);
 - A neutral or industry expert focused body tasked with monitoring and enforcing these self-regulatory or co-regulatory issues. For instance, it is not clear what role MBIE has in future for the ‘Plasterboard Taskforce’ established in 2021. But it could easily be set up to evolve into a meaningful ongoing role as a referee for the industry on supply chain problems, perhaps a “Critical Building Products Authority” rather than ad hoc plasterboard taskforce;
 - Cease and Desist orders - reflecting the reality that court proceedings are too slow, and the Commission is unlikely to seek injunctions fraught with risk and costs undertakings (we note this was removed from the Commerce Act in years gone by, but is worth reconsideration).
20. ITM is not pushing for any particular outcome or option over another. Other creative solutions may be within the expertise of the Commission or MBIE, who are best placed to evaluate all the options.
21. What we are saying is that significant vertical market power exists in a few conglomerate hands, and when there is a future supply shortage of some critical product, it will be probably played as a card again.
22. *In summary, ITM would like to see as a practical outcome of this Market Study reduced ability to foreclose – because recent events have demonstrated the capacity/incentive to do so is clearly there.*

Creeping Acquisitions, and site closures, over time

23. Vertically integrated suppliers can strategically acquire competing businesses to strengthen their dominance. They often do so in incremental steps, reflecting creeping acquisition or strategic cherry-picking of targets that are small or local in themselves, but ripe for consolidation over time.
24. This is a recurring issue with the large conglomerate firms, especially if it leads over to time to creation of a consolidate form of bottleneck facility or product. Once a merger takes place, or clearance is granted, that party then has complete freedom in future to run down a brand, or close a facility, or to consolidate stores and branches - aggravating risk of future supply squeeze.



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25. At the Conference, we mentioned the older example of CHH buying TDC mills in Northland creating the power to then choose to shut down the mill, arguably triggering the milling timber supply crisis in years to come when the Kawerau upgrade failed to be implemented effectively.
26. At retail level, ITM has seen aggressive acquisition tactics deployed by both CHH and Fletchers in “taking out” strategic ITM stores over time, including:
- older example a few years back of the acquisition by conglomerates of 9 ITM stores in the Northland region of NZ;
 - more recent acquisition by Fletchers/PlaceMakers of the 6 store Tumu Group, resulting in an estimated 75% control of the trade building supplies market in Hawkes Bay region, with Commission clearance approval (noting that Reasons for that Determination are still not available following the clearance decision granted on 29 July 2022).
27. Of course the Commission must determine each clearance application or non-notified merger on the facts and evidence it has at the time. However, we consider there should be more weighting and attention given to vertical market power issues in the process, where takeover is by one of the major conglomerate firms. Each instance gives the conglomerate player additional thickness at stages of the vertical supply chain, leverage with which to deploy vertical market power if and when it chooses. Those creeping acquisitions reinforce and solidify existing market power over time. While ITM will continue to compete and find ways to re-enter eventually, each acquisition sets the business back on its heels and reduces scale as an effective challenger.
28. **Recommendations:** MBIE should explore the case for a section 26 Commerce Act statement of government policy to the Commission, directing it to pay particular attention to future acquisitions in the building supplies sector involving vertically integrated or conglomerate issues. Further, MBIE should direct itself and other government agencies in future to carefully consider the competitive impacts of awarding Government Procurement contracts to the two large conglomerate players.


Vertical foreclosure power exists; nothing prevents its re-deployment in future market events

29. Vertical power is used and deployed only at certain times. While the power is there, the choice of strategic conduct is entirely that of the big conglomerate players. At times of stress or pressure in the industry (whilst those are not the only times) there exists the opportunity and incentive for dominant conglomerate suppliers to use market situations to strengthen their position. That can be through direct foreclosure, discriminating pricing and internal cost-shifting steps, bypassing countervailing bargaining power, or dictating unfair allocation methods.
30. ITM has given the Commission examples of input foreclosure at critical times in recent years. We were disappointed to hear that evidence dismissed as merely “anecdotal”. It reflects the market experience of ITM’s 91 member stores around the country, along with (we expect) Mitre 10’s numerous affiliated stores as well. If such evidence can be side-lined as anecdotal, or incapable of legal proof, we do not realistically see how the Commission expects to move the dial with any of its recommendations.



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31. We disagree with the related conclusion in the Draft Report that timber was a short term, temporary or one-off issue. As stated, 18 months is a long time already for market power to be exerted in timber. Use of vertical power may not be evidence right now, or at all times (particularly when two conglomerates are under close regulatory and media spotlight during this Market Study). It may then wax and wane with market conditions (e.g. new supply facilities coming on stream, or slowdown in housing demand) but there is nothing in current regulatory settings to prevent it being used again when it suits CHH or Fletcher Building.
32. The Commission should not be waiting around for its first precedent case under the new s 36 law, likely many months if not years after April 2023, to consider mechanisms that would improve the state of building supplies vertical power in the meanwhile.

Conclusion

33. It is likely that existing market power of two conglomerates, who were emboldened by the Commission's difficulties applying any meaningful s 36 deterrent in the past, will continue to influence our negotiations and discussions if and when building supplies markets encounter times of stress or shortage.
34. Exercise of vertical market power will not be an ever-present problem, it will be used again when opportunities arise for the conglomerates to do so, perhaps under cover of other economic crises.
35. ITM as a co-operative buyer group is interposed to deal with large suppliers on behalf of the needs of New Zealand builders, many of whom are small and fragmented. We have no vertically-integrated baggage or conflicts in this Market Study, unlike our two largest merchant competitor chains.
36. Thank you for considering these points of cross-submission. We are available to answer any further questions that the Commission team may have in confidential discussion.