MEMORANDUM

BELL GULLY

TO **Mya Nguyen**
OF Commerce Commission

FROM **Phil Taylor / Penny Pasley**
PARTNER Haydn Wong

BY EMAIL

MATTER NO. 400-4888
DATE 19 December 2014

Private and confidential

Submission on covenants on the Whakatu, Clive and Kaputone sites

1.1 We set out below Cavalier Wool Holdings' (**CWH**) response to the Commission's request for a submission on the rationale for imposing a 50 year covenant on the Clive, Whakatu, and Kaputone sites, given the claims that there are multiple viable sites for new scouring plant.

1.2 As they currently intend, CWH intended to impose covenants on sites to be sold in the previous application from being used for wool scouring, as confirmed in the conference on 5 May 2011[1] and noted in Decision 725[2]. The unavailability of these sites was not referenced as part of the Commission's consideration of viable sites for a new entrant, however. The Commission concluded in Decision 725 that plenty of alternative sites existed for new scouring entrants, stating it "considers that a new entry is unlikely to face significant difficulties finding a suitable site for a scouring operation in the South Island."[3] While the Commission considered a new entrant may incur "modest difficulty" in locating a suitable site in the North Island, this was not considered to be "a significantly high barrier".[4] The Commission recorded a number of sites identified by CWH in Hawke's Bay which were available and were able to meet the environmental requirements to support a new scour in the North Island, and detailed general industrial areas available in the South Island. No change has occurred to alter this finding by the Commission. As set out in its current application for authorisation, plenty of sites in the same areas detailed last time are available and CWH has offered a few examples of the many possible sites currently available in its submission of 8 December 2014.

1.3 The placing of covenants on the CWH / NZWSI sites is not intended to prevent new entrants in the wool scouring market (nor will it have this effect), but rather reflects the parties' desire not to give such a new entrant an advantage. The parties have each invested significant time, effort and money in each of the sites to set them up in a manner that reflects the party's belief is best for scouring. While the plant will be removed (and sold or used overseas), the parties do not want to give a new entrant the advantage of being able to start off with buildings that are the product of CWH and NZWSI's efforts to optimise for wool scouring. As Godfrey Hirst have previously threatened to enter the wool scouring market it is not unnatural that CWH would not want to give it, or indeed any other new entrant, a step up.

1.4 Not wanting to help a potential competitor is not sufficient, however, to cause a substantial lessening of competition. As stated in *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd (**ANZCO**)*[5] "the conduct is not made anti-competitive by the mere fact that the encumbrance was designed to enhance AFFCO's competitive position and, by extension, harm a rival's position."[6] As in that decision, the sites to be sold under covenants could at best give a new entrant a short term advantage in avoiding delays from securing consents and appropriate

[1] Decision 725 Conference Transcript 5/5/11, p 22.
[2] Para 395.
[3] Para 145.
[4] Para 145.
[5] [2006] 3 NZLR 351; (2005) 6 NZCPR 448; (2005) 11 TCLR 278 (CA).
[6] Para 276.

building configurations if these are not already present in the alternative available sites (although, as noted in our submission of 8 December 2014, some sites currently available in the relevant areas already have necessary consents in place). The Commerce Act requires a *substantial* lessening of competition, however, and as stated in *ANZCO* "short term effects are unlikely to be substantial".[7] Preventing access to a possible site for a new entrant when plenty of alternative sites requiring little investment remain could not possibly give rise to a substantial lessening of competition in the scouring market

1.5 It is the agreement between the parties to close the sites that the Commission previously considered likely to give rise to a substantial lessening of competition (not the ongoing covenants). The closure of the sites is to be considered as part of the application for merger authorisation. The possibility of covenants on the land causing such a substantial lessening of competition does not appear to have even been considered as a possibility in Decision 725 (rather the covenants featured in the Decision only to the extent of a consideration of the effect on the sales price of the land), and the covenants certainly have no impact on the current application.

1.6 The 50 year time frame of the covenants is simply a number chosen by the parties to highlight that they do not expect to see these properties used for wool scouring in the foreseeable future. A 50 year covenant is no different to a 20 year covenant or a ten year covenant; it is not possible to determine the competitive impacts of the covenants that far ahead in time and the future effects are a matter for consideration under section 27 or 28 of the Commerce Act as they arise. At the current time, there are so many sites available that the covenants will not give rise to a substantial lessening of competition.

1.7 In summary, the parties are under no illusion that imposing such covenants would prevent new entrants in the scouring market. With such a large number of alternative buildings available, the parties are well aware this is not the case. The reason for the covenants is to avoid offering a potential new scouring entrant a step up, as opposed to creating a barrier to new entry.

[7] Para 247.