

1 **CAVALIER AUTHORISATION CONFERENCE**

2 **4 MAY 2011**

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12 **[9.00 am]**

13 **CHAIR:** I think we're ready to make a start for the day if all of the attendees are here. I'd  
 14 like to welcome you to the Commerce Commission's conference on Cavalier Wool  
 15 Holdings' application for authorisation to acquire the shares and/or wool scouring  
 16 assets of New Zealand Wool Services International.

17 I am Mark Berry, the Chair of the Commission. With me today are the Deputy  
 18 Chair, Sue Begg to your right, and then going from my right, Stephen Gale and Gowan  
 19 Pickering. The Commission staff located over here are also assisting us today, as well  
 20 as Matthew Dunning who is counsel assisting the Commission.

21 The conference agenda was provided to interested parties on 2 May. We  
 22 initially set down two days for this conference. However, due to the unavailability of  
 23 Dr Layton during Wednesday and Thursday, the Commission will hold a session with  
 24 independent economic experts and legal advisors on Friday morning and that will be  
 25 held here at this venue. That will provide the opportunity for Commissioners to give  
 26 Dr Layton the opportunity to expand upon his submission and for other experts and  
 27 attendants at that session to respond.

28 As you'll know, under Section 67 of the Commerce Act, a person who  
 29 proposes to acquire assets or shares may give notice to the Commission seeking  
 30 authorisation for the acquisition. The Act requires the Commission to give clearance  
 31 for the proposed acquisition if it is satisfied that there would not be the effect of  
 32 substantially lessening of competition in a market.

33 If the Commission is not so satisfied, clearance must be declined, although it

1 may still grant an authorisation if the Commission is satisfied that the acquisition will  
2 result in such a benefit to the public that it should be permitted. If not, then  
3 authorisation must be declined.

4 Public benefits include efficiency gains and anything of value to the  
5 community generally. The focus is on the economies of scale and scope, better  
6 utilisation of capacity, and cost savings. Only net benefits are included. Any cost  
7 incurred in achieving efficiencies must be taken into account. Transfers of wealth  
8 which have no benefit to society as a whole are disregarded.

9 The Commission released a Draft Determination giving its preliminary view on  
10 the application for authorisation on 13 April. Some parties have made written  
11 submissions on the Draft Determination and public versions of these have been posted  
12 on the Commission's website.

13 Independent economic experts and legal counsel who have provided the  
14 Commission with confidentiality undertakings have also received access to  
15 confidential versions of these documents. This is on the basis that they do not reveal  
16 confidential material to their clients, or to any other party.

17 Turning to the outline for procedure for this workshop, first of all, the  
18 Commission's contact person for the conference is Antony Stewart, and most of you,  
19 I'm sure, know Antony. He's got his hand up in the back there. But if you have any  
20 questions or points you want to raise with him about procedures or administrative  
21 matters through these two to three days, please feel free to contact him.

22 The Commission has carefully read all of the submissions it has received. The  
23 Commission intends to focus the conference on the issues it wishes to further test and  
24 about which it wishes to deepen its understanding. The conference is not an  
25 opportunity for parties to question the Commission.

26 However, in saying that, I hope that as matters progress, there will be an  
27 opportunity for a dialogue between Commissioners and interested parties, such that we  
28 can have an informal discussion and full disclosure to the extent possible.

29 Previously in conferences involving authorisations for trade practices and  
30 mergers, those conferences have been done on a party-by-party basis, and we propose  
31 to follow today an issues-by-issues approach as set out in the agenda which has been  
32 provided to you. That has been the process we used in all of our input methodology  
33 conferences over the last 18 months, and we found it to be the most informative and

1 helpful way to test the various submissions. So what this means is that we will, as per  
2 the agenda, go through each issue one-by-one in the course of the next two to three  
3 days.

4 While the conference is focused on particular issues we wish to explore further,  
5 the fact that an issue is not on the agenda does not mean that the Commission has  
6 reached a final view on that matter. And I do note that we do have extensive  
7 submissions on the written record in this case in light of submissions made.

8 The Commission does not intend to request opening statements from the  
9 parties and closing submissions are not required. Rather, the Commission invites a  
10 final round of submissions, including answers to questions not able to be provided at  
11 the conference. I should hasten to add this is something of an exceptional step we are  
12 taking to accommodate the availability, particularly of experts.

13 In the ordinary course of events, we would not admit submissions after the  
14 closing of these conferences; we would only enable parties to answer questions that  
15 they could not answer at the conference. So we are providing this additional week for  
16 final submissions to be made, having regard to the full record of this conference.

17 These final submissions and answers to questions must be filed by close of  
18 play Friday, 13 May. As usual, public versions will be published on the Commission's  
19 website. I should add, and will give process directions at the close of this conference,  
20 but no new matters may be raised in these final submissions on 13 May. The  
21 opportunity is only to comment on matters that are on the record at the close of this  
22 conference.

23 The Commission members are, naturally, approaching all matters relating to  
24 this application with an open and independent mind and I do stress that our views will  
25 continue to evolve up to the point we make our final decision. At present, our hope is  
26 to make this final decision on or before 31 May.

27 The Commission procedure is not adversarial. No party has the right to ask  
28 questions of the Commission or other parties during the proceedings, unless the  
29 Commission requests that to happen. But as you'll see, as we do this, this round-robin  
30 approach with issue-by-issue, we will be typically testing one party for their views and  
31 then immediately giving the other parties the opportunity to respond.

32 My understanding is that all independent experts have formally confirmed that  
33 they have read the Code of Conduct For Expert Witnesses in the High Court Rules and

1 agree to abide by these when speaking at this conference.

2 The Commission has scheduled a confidential session at the close of each day.  
3 As confidential issues or questions arise, I will park them for discussion at this last  
4 session, at which only those parties who have signed the confidentiality undertakings  
5 may be in attendance. So we've scheduled that, at the moment, for 4 o'clock today.

6 I am very mindful as this day progress, if matters of confidentiality do arise, if  
7 our questions do start walking into confidential material, I would be most grateful if  
8 parties could immediately alert us so that we don't have any errors occurring in the  
9 course of the day, given that there is a good deal of confidential information on the  
10 table from a range of different parties.

11 The Commission proceedings are being recorded. Microphones are available  
12 for speakers at the tables as you'll see. It will be helpful if you could identify yourself  
13 for the stenographer. We do get very swift and accurate records at the end of each day  
14 from the stenographer and it will greatly help if you can identify yourself as you speak  
15 so that that record is correct at the soonest possible time.

16 The Commission expects to be able to provide interested parties with the  
17 transcript of today's proceedings early. Only experts and legal advisors who have  
18 signed confidentiality undertakings will receive the transcript of the confidential  
19 session to be held at 4 o'clock today.

20 The agenda we've set out provides breaks throughout the day. These are  
21 indicative times, and we'll work our way through any changes that might have to  
22 happen. I should hasten to add that Commissioners will not be available for  
23 discussion with people in the audience during these breaks. Our involvement is solely  
24 confined to these open public sessions. This room will remain open during the breaks,  
25 so please secure any confidential information that you have with you.

26 Just a final few housekeeping matters; first of all, tea and coffee is available all  
27 day up the back of the room. Toilets are located on the fourth floor, out the back of  
28 this room there. In the case of a fire, all attendees are to evacuate the building and  
29 gather in front of the hotel's reception area.

30 If there are new documents that are provided to the Commission for the first  
31 time at the conference, also if you could make sure that you give that to Antony  
32 Stewart in PDF form so that it can be posted as soon as possible.

33 That covers the introductory and housekeeping matters that I wish to raise. I

1 think, before we launch into the first session, it would be helpful if we simply go  
2 around the table and if parties can identify themselves for the record, we'll do that first.

3 So if we can start perhaps on this side here.

4 **MS FRANKISH:** Kate Frankish, Bell Gully.

5 **MR TAYLOR:** Phil Taylor, counsel for Cavalier, Bell Gully.

6 **MR BLACKTOP:** David Blacktop, counsel for Cavalier, Bell Gully.

7 **MR HALES:** Nigel Hales, Cavalier.

8 **MR DRAKE:** Jim Drake, Cavalier.

9 **MR CHUNG:** Wayne Chung, Cavalier.

10 **MR GEORGE:** Ross George, Cavalier.

11 **MR FERRIER:** David Ferrier, Cavalier.

12 **MR MELLISOP:** James Mellisop, NERA Economic Consulting.

13 **MR COWAN:** Keith Cowan, Wool Equities.

14 **MR HEATH:** Cliff Heath, Wool Equities.

15 **MR KIRKE:** Derek Kirke, Wool Services.

16 **MR REID:** Kelvin Reid, counsel for John Marshall Limited.

17 **MR CRONE:** Peter Crone, John Marshall & Company.

18 **MS PAULING:** Tanya Pauling, Godfrey Hirst.

19 **MR PIKE:** Kevin Pike, Godfrey Hirst.

20 **MR SUNDAKOV:** Alex Sundakov, Castalia.

21 **MR DAVID:** Grant David, Chapman Tripp for Godfrey Hirst.

22 **MR STOCK:** David Stock, counsel for New Zealand Wool Services.

23 **MS BRANSON:** Johannah Branson, standing in for Brent Layton.

24 **MR DWYER:** Michael Dwyer, Wool Services.

25 **CHAIR:** Thank you. Just before we start out, Dr Johansen(*sic*), it might be just helpful, we  
26 would welcome the extent to which you could participate, but feel free certainly to say  
27 that you prefer just to record the matter and to discuss it with Brent Layton so that we  
28 can make a note of taking up that particular issue with him. But certainly, feel free to  
29 participate to the extent that you can, but we certainly do fully expect Dr Layton's  
30 participation on all issues on Friday.

31 Okay. If there's no other points or questions, can we start with our first session  
32 that Stephen Gale will lead off on relating to --

33 **MR DAVID:** Chairman, before we start, there are a couple of procedural matters I'd like to

1 raise; the first being the divestment undertaking which arrived without explanation  
2 yesterday. The ordinary practice would be for a divestment undertaking to be  
3 produced at a time when it could be considered by the Commission and form part of  
4 the Commission's Draft Determination. I wonder if we could have some explanation  
5 as to the purpose of the divestment undertaking, just to clarify matters?

6 **CHAIR:** Perhaps if I can just take up - you'll see on the agenda for tomorrow there is a  
7 session, the last one, Ability to Achieve Claimed Benefits. We had intended, in that  
8 session, to go over the various arguments raised with the parties, that for legal reasons,  
9 the benefits would not be achievable and I'm thinking particularly of Mr Stock's  
10 submissions and Mr Goddard's submissions. So we had intended to cover off that in  
11 that session, and I think it still may be appropriate to discuss those matters.

12 So far as the late filing of the divestment undertakings, I'm assuming it is in the  
13 context of that session that they have been proffered, and it is my intention to fully go  
14 through all of those issues in that particular session by seeking an explanation for the  
15 divestment undertaking, first from Cavalier and then inviting Legal Counsel of  
16 opposing parties to make submissions in response.

17 I am mindful of the short notice of it, but I am also mindful of the fact we are  
18 giving this additional seven days for written submissions at the end of this conference.  
19 But it does seem to me that the issues are narrow legal ones, and given your familiarity  
20 with the Commerce Act, I would expect that you will be well equipped to make  
21 submissions tomorrow, and finally, seven days later in final written submissions.

22 If Mr Taylor would like to make any comments in relation to that at the point,  
23 I'd welcome those.

24 **MR TAYLOR:** Really only, Mr Chairman, that the undertaking was proffered in order to  
25 endeavour to resolve the matters raised by Mr Stock and Mr Goddard.

26 **CHAIR:** And would you see this as an amendment to the application?

27 **MR TAYLOR:** Yes. I'm not sure that it's absolutely necessary to amend the application. I  
28 think the Commission's entitled to receive an undertaking and deal with it in  
29 accordance with the Section 69A, as an undertaking that forms part of their  
30 Determination.

31 **MR DAVID:** My second point is in relation to the issues paper put forward by Bell Gully on  
32 2 May. There's a suggestion in there that Cavalier believes that the Commission  
33 should test propositions put forward by interested parties and then seek comment from

1 Cavalier. In other words, Cavalier having the right of reply to whatever other parties  
2 say. I would hope it's not the Commission's intention to pursue that approach, rather  
3 than to address issues to parties as they arise?

4 **CHAIR:** Look, the way we're doing this conference is going to be just simply issue-by-issue,  
5 where we ask questions, and we'll give all parties the chance to be heard, and that right  
6 of final submission on 13 May is a parallel right open to all parties.

7 **MR DAVID:** Thank you, Dr Berry.

8 **MR TAYLOR:** Dr Berry, just one other thing; in relation to the confidential sessions at end  
9 of the day, some of the material covered will necessarily involve information provided  
10 by Cavalier and it might be helpful at that time if, while that particular material is  
11 discussed, if members of the Cavalier financial team were available to assist in  
12 discussion of that confidential material as well as experts and counsel who have signed  
13 confidentiality arrangements, just to deal with their part of it.

14 **MR DAVID:** That raises the broader issue. We've said on several occasions that the breadth  
15 of the confidentiality claimed by Cavalier, particularly in relation to the benefits and  
16 detriments, is so extensive as to disadvantage other parties. Mr Taylor's point  
17 illustrates this. He wants his clients in the room with him and his expert so he has  
18 access to them to enable him to discuss freely the figures that they've submitted.  
19 We're denied that opportunity because of the confidentiality request, extensive  
20 confidentiality orders that the Commission has made.

21 **CHAIR:** Perhaps we can take arguments on confidentiality further at the start of that  
22 confidential session. It's a difficult situation we're facing all the time. We're in a  
23 situation where there are, you know, competing rights at issue and it is quite typical for  
24 us to be dealing with confidential material where it's only experts who have access to  
25 the data.

26 Mr Taylor's suggestion is a departure from previous standard practice and you  
27 know, my initial thinking, given the sensitivities around it, is not to engage any  
28 industry participants in that session. But can I perhaps just have a further dialogue  
29 even with counsel in the course of today and we can take this matter up further at the  
30 start of the 4 o'clock session.

31 **MR STOCK:** Dr Berry, we'd like to add to that on behalf of Wool Services. There has been  
32 an exchange of information between Wool Services and Cavalier at an earlier date  
33 where very confidential and sensitive information was disclosed to Cavalier which has

1 enabled them to build up their position in respect to the figures, but the similar figures  
2 from Cavalier have not been made available to Wool Services, and cannot under  
3 confidentiality. That is considered by Wool Services to place them at a major  
4 disadvantage which they should not be at in respect of making comment on the  
5 figures.

6 **CHAIR:** What were the terms and conditions of the release of the data last year?

7 **MR STOCK:** It was under a confidentiality agreement, but they have had access to Wool  
8 Services' information.

9 **CHAIR:** Can we just take confidentiality - these points are noted for the record. I think, so  
10 that we can get the process underway today, I am eager to get the wheels turning on  
11 the substantive matters, but can we take up the confidentiality arguments at 4 o'clock  
12 at the start of that session again? That would be helpful.

13 Okay, are there any other process issues? **[No comments]**. Okay, I'll ask Dr  
14 Gale to commence questions on the first topic, Potential Price Impacts.

## 15 16 **POTENTIAL PRICE IMPACTS**

17  
18 **COMMISSIONER GALE:** Good morning, everybody. This section is about potential price  
19 increases and the possibility of allocative losses, and we'll come to be clear about what  
20 we mean about that in time. So what might Cavalier choose to do and be able to do  
21 after the proposed acquisition? That's the focus. What scouring prices would be  
22 achievable, given the likely responses by merchants and downstream producers of  
23 carpets and yarns?

24 We've had quite a range of estimates provided to the Commission. In the first  
25 round of submissions, opponents to the deal postulated that prices could go up by as  
26 much as 20 percent. In the second round, Futures estimated that the scouring price  
27 would need to treble before downstream producers could re-import New Zealand wool  
28 scoured in China. For the same manoeuvre, Castalia estimated an 83 percent price  
29 increase.

30 Alternatively, Futures have calculated that the scouring price would need to go  
31 up by nearly 40 percent before Godfrey Hirst or other investors would build a new  
32 scouring plant. So our questions are aimed at narrowing this range of possible price  
33 effects.



1           As you know, the main reasons for wanting to understand these constraints on  
2 prices is to estimate the potential for allocative losses. In other words, the economic  
3 waste if Cavalier found it profitable to forego profits on some of the scouring that's  
4 done for export in order to make more profit from the more captive users.

5           So first, the baseline for the analysis of price effects, what we unattractively  
6 call a 'counterfactual'. So what would happen if Cavalier doesn't buy WSI? My first  
7 question is, and I direct this question first to Cavalier. If Cavalier doesn't succeed in  
8 buying Wool Services, what would you expect? Do you expect Godfrey Hirst would  
9 buy it, do you expect that a coalition of merchants would buy it? Let's start with that.

10 **MR HALES:** Nigel Hales, Mr Chairman, Mr Gale. That could be a collection of any one of  
11 those answers.

12 **COMMISSIONER GALE:** Okay. Do you expect that the merchant scouring model would  
13 continue if it was purchased by Godfrey Hirst, or knowing what you know about the  
14 industry, what do you think would happen to that merchant scouring model for the  
15 WSI assets?

16 **MR HALES:** I'm sorry, I couldn't comment on what some other company may do.

17 **COMMISSIONER GALE:** Fine. Fine. I wondered also if you have a view about whether,  
18 given Cavalier's anticipation of how this business might operate, you're confident that  
19 scouring for export will continue in New Zealand?

20 **MR HALES:** Yes, I believe it will.

21 **COMMISSIONER GALE:** In a lot of our initial material, we examined the experience in  
22 Australia, and we wondered how confident parties in New Zealand can be that the  
23 same thing won't happen to the scouring industry in New Zealand, as happened in  
24 Australia.

25 **MR HALES:** I think the different scenario with New Zealand is that we've managed to  
26 restructure the volumes of scouring capacity around the volumes of sheep production  
27 or wool production, which is something that the Australians didn't do.

28 **COMMISSIONER GALE:** Okay. So what, they carry too much cost by carrying too much  
29 capacity?

30 **MR HALES:** I believe so.

31 **COMMISSIONER GALE:** Thank you. Can I ask the same question to Godfrey Hirst,  
32 whether Godfrey Hirst would expect the merchant scouring model to persist?

33 **MS PAULING:** If it was purchased by us, you mean? We would - it's a bit hard to say at the

1 moment, probably it would continue in some form, but there would be more  
2 commissioned scouring being done.

3 **COMMISSIONER GALE:** Thank you. Similarly, the same question; are you confident  
4 about the future of scouring for export in New Zealand?

5 **MS PAULING:** Well, I guess that's more a question that Cavalier can answer, but yes, there  
6 will be scouring for export.

7 **COMMISSIONER GALE:** Okay. Anyone else want to make a comment on those matters?

8 **MR DWYER:** Michael Dwyer from Wool Services. In terms of confidence in exports, yes,  
9 we are very confident in the future of scoured wool exports out of New Zealand. We  
10 also believe that the model that we have developed is the best in the industry and is the  
11 most effective and efficient.

12 **COMMISSIONER GALE:** Okay. So you don't stay awake late at night worrying about the  
13 Australian experience. What distinguishes the New Zealand setting from what  
14 happened from scouring moving right out of Australia?

15 **MR DWYER:** The Australian situation actually is quite different from New Zealand, in that  
16 the end use for Australian wool was principally for clothing, making fine cloths, and  
17 for the top-making industry, which moved out of Europe and moved into China. So  
18 that the end use of Australian wool overall is very different to that of New Zealand  
19 wool.

20 New Zealand wool is principally - the biggest end use is carpets because of the  
21 coarse fibre that we produce here, and also mid-micron wools which are destined for  
22 the coarser end of the cloth industry, such as interior fabrics, heavier type of clothing  
23 for knitwear and so forth. It's quite a different industry.

24 Furthermore, it has a very much more diversified spread throughout the world.  
25 China, whilst it has a very large share of the New Zealand market, does not enjoy the  
26 same percentage as they do in Australia. 80 percent of all the wool being shipped out  
27 of Australia goes to China. In New Zealand it's about 30 something, 35 percent, and  
28 that will vary, and it has remained reasonably constant over the last 10 years.

29 **COMMISSIONER GALE:** Thank you. Does anyone else want to comment from that, from  
30 Masurel or Marshall?

31 **MR GEORGE:** Ross George from Cavalier. We're a recent investor in Cavalier, that's been  
32 one of the issues we spent a lot of time on. We invest in a variety of industries. When  
33 we look at the risks of industry staying in New Zealand, and moving to China, our

1 analysis is it's very rarely anything to do with the product itself, it's just to do with the  
2 price differential between carrying out whatever function you carry out here, and  
3 carrying the function out in China. In this instance, China.

4 There is a substantial differential from our analysis and the price of scouring in  
5 New Zealand and scouring in China. As an investor across many industries, we've  
6 seen many industries leave New Zealand because of that differential, and it's  
7 incumbent upon us in New Zealand and in the scouring industry in particular to make  
8 sure that that differential is either small enough or that the quality and service is either  
9 good enough for people not to want to do it.

10 But I think it is - I mean, I think it is absolutely the right issue for everyone in  
11 the industry and the right issue for us as investors as well. A lot of industries will tell  
12 you they're different and you hear it in a lot of industries, but the fact is, from our  
13 analysis, it's just the price differential in the service between New Zealand and China.

14 **COMMISSIONER GALE:** Thank you.

15 **MR PIKE:** Mr Chairman, Kevin Pike for Godfrey Hirst. It's our belief that the reason for the  
16 sudden demise of wool scouring in Australia is more a result of the removal of the  
17 further processing industries in Australia to China which gave rise to the opportunity  
18 for the wool to be scoured in China as a result of that, whereas in New Zealand at  
19 present, we have vertically integrated manufacturing businesses that require scoured  
20 wool and that's the main difference between the New Zealand and the Australian  
21 industries, and that's the reason why there is less risk of the scouring being removed  
22 from New Zealand in the counterfactual.

23 **COMMISSIONER GALE:** Thank you. Any comment from - sorry, Mr Dwyer?

24 **MR DWYER:** Sorry, thank you. I just would like to add, if it's of help. The scouring  
25 industry in New Zealand is actually gaining in strength in China. Over the last five,  
26 six years, the amount of wool being scoured in New Zealand as a percentage of the  
27 total shipments is increasing, and is increasing quite dramatically.

28 The percentage of scoured wool being shipped to China has moved from 36  
29 and a half percent in 2007/2008, to 42.45 percent in the current year. I think that tells  
30 a story.

31 **COMMISSIONER GALE:** Is it true to say, though, that the absolute amount of greasy wool  
32 being exported to China is still increasing, though?

33 **MR DWYER:** Not according to these latest figures.

1 **COMMISSIONER GALE:** So that differs from our information. Thank you.

2 **MR HALES:** Yes, we'd dispute those figures. We think the total exports going to China are  
3 on the increase generally. That it is - Michael is correct - scoured and greasy is  
4 increasing as well.

5 **MR PIKE:** We believe that the amount of greasy wool exported to China in the last five  
6 years, and this is supported by Cavalier's information, has only increased by 5 percent,  
7 or excuse me, this is the amount of wool exported greasy from New Zealand in total to  
8 all markets has only increased by around 5 percent.

9 But more importantly, if we go back six years, the amount of greasy wool  
10 exported from New Zealand to all markets is still less than it was, and in addition to  
11 that, China is processing more New Zealand greasy wool simply as a result of the  
12 transfer of wool that was exported to other markets now being exported to China.

13 **COMMISSIONER GALE:** We'll come back to that point. Thank you.

14 **MR HEATH:** Mr Chairman, Mr Gale, Cliff Heath, Wool Equities. Certainly, your first issue  
15 that you raised was on the issue of ownership going forward. Clearly, as  
16 representatives of farmers, we would see that it's fairly critical that there is a degree of  
17 farmer ownership or influence in the scouring sector; primarily, to ensure that, first of  
18 all, that price is not handed back to farmers in lower returns, that's to protect what is  
19 still, although it be not as strong as it once was, a cornerstone position of this  
20 New Zealand economy. That is, the sheep farming and wool industry.

21 Secondly, it is critical that there is commissioned scouring retained within this  
22 country to enable destination of product to be maintained. That is to say, that the  
23 ability for product to go to virtually any country in the world in a clean form. If we  
24 don't have that commissioned scouring and that scouring is in fact concentrated to the  
25 users of - the vertical integrated users such as Cavalier within this country and that all  
26 of the balance of the wool has to go to China to be scoured, then basically that wool  
27 will all be used in China, there will be very little scoured wool exported from China.

28 That, consequently, affects the users of New Zealand wool in the US, in  
29 Europe, and in other countries of the world. That is a critical issue I believe; the  
30 retention of commissioned scouring for that purpose, to allow options for destination.  
31 Thank you.

32 **COMMISSIONER GALE:** Mr Whiteman, Mr Crone, any comment from --

33 **MR CRONE:** Yes. Peter Crone. There's a lot being said about China. I presume we're

1 talking about exporting greasy wool scouring in China and re-exporting, is that --

2 **COMMISSIONER GALE:** No, not really.

3 **MR CRONE:** -- not the thrust of it?

4 **COMMISSIONER GALE:** Not from the numbers that people have volunteered.

5 **MR CRONE:** No, no, but in this report it suggests that that could happen. We have a  
6 business in Christchurch which processes scoured wool which is scoured at Kaputone  
7 Wool Scour and we wouldn't be able to operate that business if we had to scour wool  
8 in China and re-import it. The constraints of doing that would just be mind-boggling,  
9 quite frankly. With the Chinese bureaucracy, you just couldn't do it. So if that's one  
10 of the reasons, then I'm afraid that's not valid.

11 **COMMISSIONER GALE:** No. I guess my question to you would be that in respect of the  
12 sales you make to China, are you confident that it will continue to be the case that it  
13 works out economically, that you would have it scoured here and sent to China as  
14 opposed to the Chinese customers saying, for heaven's sake, just send us the greasy  
15 wool?

16 **MR CRONE:** No, no. I think while there's much made about the tariff differences and we're  
17 aware of them, a lot of that today is based on the grease recovery that China are  
18 undertaking. Those prices don't last forever. We are also watching closely the labour  
19 costs increasing in China, wages have gone up significantly in the last year alone,  
20 some say by 20 percent at least.

21 This slowly is going to have an impact, the same impacts that it had in Japan in  
22 the past, in Korea, Taiwan, all those markets were low cost economies. They're no  
23 longer low cost, and in fact, Korea changed virtually overnight and all the industry has  
24 disappeared.

25 Now, I don't see China remaining cost-competitive with New Zealand, who  
26 have the most efficient scouring operations in the world.

27 **COMMISSIONER GALE:** Okay. So still in the world of the counterfactual, the next  
28 question is, how much does WSI constrain Cavalier Wool at the moment? We have  
29 read the submissions, so I'll just focus on a few questions. Can I ask Wool Services,  
30 Mr Dwyer, if Cavalier increased the prices of scouring now, would you have the  
31 capacity to take on a substantially larger proportion of the New Zealand wool clip for  
32 commissioned scouring?

33 **MR DWYER:** It would depend - sorry, I'll answer it this way. It would depend on what time

1 of the year. We don't run our plants 24/7 throughout the year. We would like to, and  
2 we have done, but at the present moment, we do it for about six months. So we would  
3 have quite a bit of surplus capacity to absorb an increase in business, commissioned  
4 business.

5 **COMMISSIONER GALE:** Thank you. I understood from Mr Heath's submission that you  
6 were running 24/7.

7 **MR DWYER:** Correct. At the present moment, we would have no spare capacity.

8 **COMMISSIONER GALE:** Do you compete with the merchants in all markets? We're  
9 wondering about how much the market shares move around between you and the  
10 merchants who are selling in various off-shore markets, where sometimes you would  
11 have an entree and pay more at the auction as a consequence, and gradually move  
12 wool volumes around. Are those volumes of wool market shares volatile, or do you  
13 have a fairly stable customer base?

14 **MR DWYER:** We have fortunately a very stable customer base, and we do aim to achieve  
15 certain market shares in various countries. In fact, that's how we plan, strategically  
16 plan, our business, to ensure that we have a certain market share in every one of the  
17 main markets. But those market shares will vary from market to market, and we will  
18 have higher market shares in certain markets and lower market shares in other  
19 markets.

20 A lot of it has to do with price, with our ability to communicate with the  
21 clients, and it's all about people at the end of the day, and our relationship with those  
22 clients. That's what will determine a lot of our market share.

23 **COMMISSIONER GALE:** Thank you, okay. So they vary from country to country, but do  
24 they vary from month to month or from --

25 **MR DWYER:** Yes, they will, but the overall pattern will remain the same, if taken from a  
26 macro look at it. But it will vary. Some months will be down on last year, some will  
27 then recover, but overall, our market share, overall, remains pretty constant.

28 **COMMISSIONER GALE:** In dealing with your customers, do you see any particular  
29 advantage in non-price effects? The fact that you have your own scouring plant?

30 **MR DWYER:** That is a vital aspect of our business. It's part of our marketing strategy, it's  
31 part of our branding strategy, and it gives tremendous confidence to our clients, that  
32 they can be assured of constant quality, deliveries just on time, and they know very  
33 well that, as a supplier, we will always honour our contracts, given whether the market

1 goes up or down.

2 **COMMISSIONER GALE:** Okay. Questions to John Marshall, Mr Crone. Our impression  
3 is that the independent merchants prefer not to have wool scoured by WSI because its  
4 a trading competitor. I wondered whether, in your mind, this already gives Cavalier  
5 some sort of commercial advantage? Does that enable them to charge slightly more  
6 because --

7 **MR CRONE:** Enable Cavalier to charge more?

8 **COMMISSIONER GALE:** Yes.

9 **MR CRONE:** Certainly if we did a cost comparison, which we actually did for the month of  
10 April, the cost to us for that month if we'd scoured all our wool with Cavalier, would  
11 have amounted to \$45,000 more. That's largely a big freight component. So the cost  
12 of scouring itself is not a large differential, it's really a freight movement situation for  
13 us.

14 **COMMISSIONER GALE:** Okay, thank you. You described that you scour at the Kaputone  
15 plant. Does that mean it has some sort of product advantage for you?

16 **MR CRONE:** Firstly, we have a plant in Christchurch which uses scoured wool, so that is an  
17 advantage to us, just in time deliveries. But we've also found it to be very efficient  
18 and the quality is excellent. It's not to say it's significantly better than Cavalier at all,  
19 but certainly, it's as good as if not better. It's just very subjective.

20 **COMMISSIONER GALE:** Thank you. Any other comments?

21 **MR DWYER:** Sorry about this, I didn't make one point because it was part of your question,  
22 I apologise.

23 In terms of commissioned work achieved at both our plants, if you don't mind  
24 I'll read them out, in 2008/2009 the amount of commission work at Whakatu was a  
25 total 1.14 percent of our total throughput. At Kaputone it was 9 percent of our total  
26 throughput. The following year, 2009/2010, Whakatu, 10.2 percent, at Kaputone,  
27 17 percent commission work. The current year, 2010/2011, at Whakatu, 13.3 percent  
28 and at Kaputone, 25 percent.

29 **COMMISSIONER GALE:** So in those settings, you bought less yourselves to take on the  
30 commissioning work?

31 **MR DWYER:** In the current year, well, we have been very, very busy, put it that way.  
32 Production has - we have been flat out, in other words.

33 **COMMISSIONER GALE:** Actually, you touch on an issue that has mystified us a bit,

1 because there seems to be a disagreement about the market share that your company  
2 has in the commissioned scouring work. If you wanted to send us some numbers  
3 about this afterwards, that would be very helpful to try and lock that down. Thank  
4 you.

5 **MR PIKE:** Excuse me, just in terms of the competition question, Godfrey Hirst have the  
6 opportunity to also scour wool through Wool Services, in that if Wool Services choose  
7 to offer wool to Godfrey Hirst and the price is acceptable, Godfrey Hirst has the ability  
8 to purchase it. That, in effect, is competition between Kaputone and the Cavalier  
9 Wool scourers.

10 **COMMISSIONER GALE:** Is that just head-to-head price competition at the margin for the  
11 bid outside your contract?

12 **MR PIKE:** It's not as transparent as that, because when Wool Services offer wool, it's  
13 offered on condition that the wool is scoured through Cavalier, sorry, through their  
14 own plants. When all the other merchants that supply Godfrey Hirst offer wool,  
15 they're aware that that wool has to be scoured through Cavalier's plants.

16 **COMMISSIONER GALE:** Okay, thank you. Go on.

17 **MR PIKE:** So Wool Services are the only ones who can provide competition to Cavalier in  
18 terms of Godfrey Hirst's business.

19 **COMMISSIONER GALE:** In the nature of that competition between the two scourers, is  
20 there more to it than time of delivery and price?

21 **MR PIKE:** To us, it's pretty much we buy the wool and it's delivered on the day, and in  
22 terms of the competition, that's something that we're aware of, but not directly  
23 involved in.

24 **COMMISSIONER GALE:** Thank you. We wondered whether, and we might come back to  
25 this later, you're doing all your research and development with Wool Services out of  
26 view of your competitor. But we'll come back to that later in the session. Thank you.  
27 Cavalier is next on my list.

28 **MR CHUNG:** Wayne Chung from Cavalier. I'd just like to respond to Mr Pike's comment  
29 about getting the wool from WSI. I just want to make it clear that in the factual, that  
30 would still be the case. In other words, we'd like to believe that WSI Trading will still  
31 exist as an entity and would continue to supply the market, including Godfrey Hirst.

32 His comment regarding this competition with us, we're just pure scourers, we  
33 actually don't trade in wool. So we provide a service to anyone, including wool



1 exporters. And even WSI, if they run out of capacity, we would provide them the  
2 service as well.

3 **COMMISSIONER GALE:** Any comments from the economists? Castalia?

4 **MR SUNDAKOV:** Perhaps if I could just comment on a few things that have come up.  
5 First, just I think on the question of - you raised right at the beginning the question of  
6 how do we narrow the range of estimates of what is the price differential, and  
7 therefore, what's the potential for the uplift. I mean, clearly these estimates rely on  
8 information from the industry and on a kind of a way of putting it together that  
9 captures all the relevant elements.

10 I guess a slight difficulty I see with the process for narrowing that range is that  
11 a lot of that is confidential and we kind of can't debate it here, but when we have a  
12 confidential session, we don't have the industry specialists with us. So there's a little  
13 bit of a catch 22 in arriving at that. So I just kind of want to leave that with you, to  
14 think whether there is some way to resolve that, because I don't quite see a process.

15 I think in relation to the broader issues that have been discussed, I just want to  
16 make a couple of comments. I think one, I think a number of points have been raised  
17 by various participants, really emphasise the vertical issues that exist in this industry  
18 and I suspect we'll come to them in a later session. But it's quite clear that the - you  
19 can't consider the location of scouring and the choice of where to scour purely on price  
20 effects, it's also related to the location of where the final use is. And that, I think, has  
21 quite an important impact on how we interpret a lot of these results.

22 I think that probably the second general observation is that, just responding to  
23 the point about how competition is conducted, it seems to me that in the factual, the  
24 fact that WSI may remain a separate entity and offer a product as a separate entity,  
25 doesn't really contribute to competition because the fact that something is a separate  
26 entity seems to me to be somewhat secondary to joint ownership and the incentive to  
27 compete.

28 **COMMISSIONER GALE:** Thank you. Mr Mellsop.

29 **MR MELLSOP:** Thank you, Commissioner. Just a couple of brief comments, I guess.  
30 Your questions, to me, seem to be bang on in terms of trying to work out what  
31 constraint WSI does impose today and under the counterfactual. So sort of market  
32 share, so the information that Mr Dwyer mentioned is interesting. I guess the key will  
33 be is that that share, as I understand it, of his own throughput as opposed to

1 commissioned scouring which will be the correct question.

2 I also think the discussion about China, it seems to me that everybody is  
3 agreeing that China is a growing market for wool. So I think when looking at the  
4 constraints that WSI imposes, it's intriguing to ask if it's correct why its share of the  
5 scouring market is small and static, if that's correct, as opposed to China which is  
6 growing, subject to confirmation of the facts there.

7 Then your question about capacity; look, I think that's a good question. Again,  
8 I wasn't quite clear on the answer to the question about capacity. It seemed to me  
9 there were two answers, but perhaps that can be clarified.

10 **COMMISSIONER GALE:** It sounded like it would be a matter of storage at the very least  
11 that would have to be carried over to some other time in the year. Thank you.

12 Ms Branson, do you want to chip in?

13 **MS BRANSON:** No.

14 **COMMISSIONER GALE:** Thank you. Have I missed anything? [**No comments**].

15 Now to the factual, to the proposed acquisition. It goes without saying, at least  
16 for economists, that the merged entity will increase prices if it finds it profitable to do  
17 so. So our focus is really on the constraints on price, on possible price increases.  
18 Those really come down to the two things; China, in inverted commas, as a sort of  
19 general idea, and the prospect of entry or re-entry.

20 So doing those in the reverse order, can we talk about entry for a while. Here,  
21 I think we will have to discuss some of this in closed session. Because I take it  
22 Cavalier still would like to have the calculations that Futures did with its information,  
23 kept in confidential session, is that right?

24 **MR TAYLOR:** Yes.

25 **COMMISSIONER GALE:** Okay. Can I just ask Cavalier --

26 **MR TAYLOR:** Sorry, perhaps if I could just say that I think Mr Mellsop might be able to  
27 make some general comments regarding the nature of the figures and what he's seen as  
28 a result of those. It may be helpful to progress the discussion.

29 **COMMISSIONER GALE:** Right, yes. Thank you. So can I ask you just to briefly  
30 summarise what you see as - we'll let everyone have a comment on this - the barriers  
31 to building another scouring plant. The impression that we've got is that something  
32 like a single line, 2.6-metre, maybe slightly larger, something of that size, might be the  
33 thing that people would enter with.

1           What barriers you see people might face to coming back into the market,  
2 whether we've got the right scale, you know, a scale that's basically efficient and not  
3 disabled by being too small, and whether you have an impression from, amongst the  
4 investors, what rate of return an entrant might require.

5           I guess we assume, I won't put thoughts into your head, but it seems to me that  
6 people would re-enter backed by some sort of commitment from merchants, if it wasn't  
7 actually the merchants themselves reinvesting.

8           So can I ask you to lead off, just help summarise what you think the prospects  
9 of re-entry are. How you see your competitors - how you see Godfrey Hirst or a group  
10 of merchants or some other investors, some independent investors.

11 **MR GEORGE:** Would you like me to start off with --

12 **COMMISSIONER GALE:** Yes, I would actually, because I was interested in your view of  
13 the rate of return question.

14 **MR GEORGE:** Again, as we looked at the China risk, we looked at new entry risk as well.

15 But the new entry seems to us to have to be generated from within because, as  
16 everyone knows, it's extraordinarily sensitive to volume and it is very high capital  
17 input to establish, and the capital cost in a scouring operation is all upfront, so you  
18 need to have parties that are prepared to commit product to it, and because it is so high  
19 capital cost and because it is all front-loaded, the way you'd have to do it is you'd have  
20 to have quite a long-term take or pay agreement with people that wanted to see a  
21 scouring operation, and again, no different to any other industry you would have seen.

22           The equipment is readily available, both new and second-hand, and we talked  
23 to one of the equipment manufacturers here when we were starting off to see exactly  
24 what that risk was, and interestingly enough, when we did speak to them, they were  
25 busy on the China contract, so presumably our equipment is going to China as well, to  
26 establish scouring plants there.

27           But the equipment manufacturers don't finance you into this, into a start-up  
28 operation, but the equipment financiers will, but again, require the take or pay - you  
29 know, again require the volume people to back it. And I suppose, other than that, we  
30 got some expert advice on the likelihood of buying land and resource consents and  
31 there are areas you can carry out this industry and there are areas you can't, and the  
32 advice was if you were looking to start up an operation, and we got a list of the  
33 industrial parks that you could do it in and a list of the parks that you probably couldn't

1 do it in, and that's obviously all about the discharge primarily, but other areas like  
2 smell and noise as well.

3 **COMMISSIONER GALE:** Does the fact that it's - sorry, you said, just before I lose that  
4 thread, you said it's capital-intensive. My impression was that the return on capital  
5 was, I don't know, a third or something of the total - I might have that wrong, but we'll  
6 come to those proportions later, but also you mentioned the equipment is sold  
7 second-hand. I wondered if that made you think, well, is that slightly less of a worry,  
8 then, that people would enter in, if everything turned to custard, they'd sell it again. Is  
9 that market liquid?

10 **MR GEORGE:** I don't know that, actually, but I know at the time we made inquiries there  
11 were some plants available. I forget the countries, but one of them, I know, was  
12 Australia.

13 But when I say it's capital intensive, it's obviously not just the - you need a  
14 building and you need some land and you can obviously lease both of them, but again,  
15 the landlord's going to want to see the volume committed as well, so again, it would  
16 suggest that it's come from within.

17 Banks; well, there's likely to be operating losses when you start up and banks  
18 are reasonably comfortable at funding those sorts of things if they can see long-term  
19 commitment to it. I think we all know, with this industry and other industries as well,  
20 that a lot of people will sit around and watch and wait until it's established and then  
21 join up, so you would assume you'd start with lower volume and then move into higher  
22 volume.

23 I think those are all - the rate of return question you asked, I mean, I always  
24 find that hard to answer because it would be very, very subjective, but it would depend  
25 to us on what sort of volumes we could see committed through and what kind of  
26 timeframe, and we would just put risk probabilities on that.

27 These guys have asked me as well. I haven't really got a number. I think it's  
28 sort of unreasonable to be able to put a number on something that you don't know how  
29 it's going to shape up.

30 **COMMISSIONER GALE:** Yes, it may be contract specific, yes. WSI first, and Godfrey  
31 Hirst after that. Mr Dwyer, do you have a comment about that? If you were starting  
32 afresh, could you find a location?

33 **MR DWYER:** I would just say that 20 year, or 22 years ago, there were about 24 wool

1           scourers in this country. Now there are four operating. I think the answer's very clear,  
2           that the chances of a start-up of a new greenfields operation is extremely remote. I  
3           think that there are too many environmental problems to be overcome, I think the cost  
4           is prohibitive, I don't believe there is the capital in the industry to support it, and I  
5           don't believe that there is any organisation that is capable of really having a successful  
6           operation, and certainly not when - you know, providing the situation remains  
7           competitive here and not a monopoly, then I think that the situation of a new entrant is  
8           very unlikely.

9           **COMMISSIONER GALE:** You say it's very capital-intensive or that it's very expensive.  
10           But the proposition here is that Cavalier is making it quite attractive. You know, if  
11           prices went up, what would stand in your way of producing a quarter of the WSI  
12           enterprise, you know, one train somewhere?

13           **MR DWYER:** There is always that possibility, but whether you would be able to compete in  
14           the real world of high-quality scouring, etc, much as WSI is doing right now, I believe  
15           the chances are very slim.

16           **COMMISSIONER GALE:** Thank you. Godfrey Hirst.

17           **MR PIKE:** I've got a couple of points. First of all, in terms of the location of any new  
18           scourer in New Zealand, I think as the wool industry has centralised its production in  
19           each Island, particularly in the North Island to Napier, that means that any new scour  
20           built in the North Island will also need to be in Napier, otherwise it will be penalised  
21           through increased freight and delivery costs. The same applies in the South Island, in  
22           that the scour would need to be in Canterbury and it's my view that Christchurch, for  
23           that reason, is a better location because the wool comes predominantly through  
24           Christchurch, but also is mainly exported out of Lyttelton.

25           My next point is that in order to be properly competitive, any new entrant will  
26           need a scourer in both Islands. And the reason for that is that if they were to build a  
27           scour in one Island in the factual, Cavalier could penalise commissioned customers  
28           who wanted to process with the new scour, by increasing the costs of processing in the  
29           other Island where they didn't have a choice.

30           My last point relates to a question you asked a little while ago about the size of  
31           a scour, I think you mentioned 2.6-metre scour. Again, our view is that to be properly  
32           competitive, a new entrant would need to install a 3-metre scour because all the cost  
33           efficiencies that come with that size machine are reduced if you were to purchase and

1 install a smaller machine; things like labour costs and what have you.

2 So in terms of competition, our view is that you need a 3-metre scour which is  
3 probably the hardest machine to find second-hand, and also the most expensive to buy  
4 new. You need a scourer in each Island which has just doubled your costs, and you  
5 need to locate your scours very close to Napier or Christchurch, where there are very  
6 limited choices in terms of available suitable sites.

7 **COMMISSIONER GALE:** Thank you. So a 3-metre scour, what's the throughput on that,  
8 do you know?

9 **MR PIKE:** I think there's more qualified people in this room to answer that.

10 **MR DWYER:** Approximately, on an annualised basis, providing you're running at maximum  
11 capacity, approximately 200,000 greasy bales a year.

12 **COMMISSIONER GALE:** Thank you. Okay. There was another --

13 **MR CHUNG:** Yes, I'd just like to respond to Mr Dwyer's comment about this prospect of  
14 less likelihood of a new scour being set up. I think we agree with that, but only to the  
15 extent that we behave ourselves, just as Cavalier, in terms of how we price. I think it's  
16 very important that it's the threat really of a new scour that would come in would  
17 worry us the most because once we create that situation, it's permanent loss for us. So  
18 we're always very, very careful about actually how we handle the trade.

19 So talk about the price of entry. I think if there was an entry by a couple of  
20 wool exporters who were very, very disappointed with us, the way we behave, they  
21 would just simply pool their resources together, this is the scouring volume, and I  
22 suspect they would not buy something new, they would actually buy something  
23 probably more second-hand off-shore, which is much, much cheaper and hence  
24 achieve a fair return on their funds employed.

25 But I think the key thing I'd like to reinforce here, it's more the threat rather  
26 than actually doing it. We've actually listened very carefully to our customers to make  
27 sure that we actually don't lose the volume on a permanent basis.

28 **COMMISSIONER GALE:** Yes, I think the thought experiment we're conducting is exactly  
29 that, what's the limit that you would just say safely under, not imagining it would  
30 happen.

31 **MR COWAN:** Keith Cowan from Wool Equities. In a past life, I was a wool merchant  
32 exporter, ran a company called H Dawson. There's a couple of issues that I'd like to  
33 bring up. First is that it just doesn't take a bit of steel and a plant, a 3-metre plant, to

1 actually run a wool scour; you actually need expertise. We have a limited amount of  
2 expertise here now, and if we lose that expertise, the bit of machinery is probably  
3 going to take an awful long time to get going.

4 We saw a 3-metre scour go into Timaru with Cavalier some time ago and we  
5 all experienced wet wool for quite a considerable period of time, and we watched a lot  
6 of aggro go through there. We wouldn't want to have to go through all that again. It  
7 took quite a while, I can't tell you exactly how long, but there was a duration of  
8 probably six to eight months, a period through there.

9 I think Peter Crone might know more about that than I do, but you just  
10 wouldn't want to go through that again and again. And the cost to Cavalier must have  
11 been considerable in terms of the lack of throughput through that plant and the amount  
12 of claims that went against it.

13 **COMMISSIONER GALE:** Thank you. Yes, I had read that wool graders were a particular  
14 skill-set. That the skill-set you're thinking of, the graders and the --

15 **MR COWAN:** There's lot to getting these plants right. Michael Dwyer and Cavalier will  
16 probably be able to tell you a lot more about it than I will, but I've sat on the peripheral  
17 as a customer and looked at it and not all wool goes through identically. The night  
18 shift wool is different to the day shift wool, it's different to the weekend shift wool,  
19 and unless you have the right people and the right place doing the right jobs, it doesn't  
20 happen, no matter what the bit of kit is.

21 **MR STOCK:** Mr Commissioner, we do have an expert on installing scours sitting at the  
22 back who could, I think, tell you about this, if you wish to here. Ian Caradus, who was  
23 the General Manager who started both the new scours at Whakatu and Kaputone when  
24 they were installed.

25 **MR CARADUS:** Yes. I think we were the first ones to take the opportunity to introduce  
26 new technology to the industry and some 14 years ago we commissioned Andar at the  
27 time to create a new 3-metre plant which really revolutionised the costs of our process.

28 But having said that, it is not just a matter of installing and commissioning a  
29 plant; there are a great number of variable factors which slow the process down, and if  
30 you did choose to go - relocate plants - my view is that it would take anything up to  
31 about six months to get fully operational without all the bugs taken out of it.

32 So I've had the experience of selecting the technology for the Whakatu plant,  
33 and we thought very, very carefully on what we wanted to serve our clients best. But

1           that plant took us exactly a year to get up to full operational efficiency, and I'd be very,  
2           very cautious about the costs involved if did you want to set up one of these plants.

3   **COMMISSIONER GALE:** Thank you. Cavalier, are you worried that all your best people  
4           are going to go to China and you won't have anyone to sort the wool?

5   **MR FERRIER:** Commissioners, David Ferrier, Cavalier. We've never been a sexy industry  
6           and we are worried about attracting people into it. We're proactively involved  
7           continually on training and retraining, and even at the moment, are looking really how  
8           we can get back involved with some of the educational institutes to try and generate  
9           more interest and enthusiasm for getting into a career in wool.

10           I've been a little bit concerned there, the general discussion about new entrants.  
11           There appear to be a large number of parties interested in acquiring and getting  
12           involved in wool scouring, as much as 13 or 14. I don't think it takes a great leap of  
13           faith to expect that some of those who have registered interest, looking to get involved  
14           might, find an optimum situation in the event that our initiative is successful to get  
15           involved.

16           We obviously don't expect that will happen, we don't want it to happen, we  
17           can't go near the line ever where that might happen, but that's a behaviour that we can't  
18           control and that we're obviously open to if this initiative is successful. We are  
19           obviously mindful of it, a lot of money is invested. But there do appear to be from,  
20           Peter Crone and a number of other people around, a preparedness. We're hearing  
21           off-shore initiatives being talked about, whispered about, so the threat is very real. We  
22           don't go near it, we'll do everything in our power to avoid it, but certainly, there do  
23           seem to be parties prepared to get involved in wool scouring.

24   **COMMISSIONER GALE:** Thank you.

25   **MR DWYER:** I'd just like to, if I may, thank you. There was mention made of a new scour  
26           being manufactured. It was at Andar, and it's known as a Topmaster scourer. That  
27           means that the wool that it will be scouring is for fine wool. If you want to have plants  
28           like WSI have got, they're known as Cardmasters, and the difference is that they are  
29           geared and built to a standard that is best suited for scouring coarser wools. This  
30           particular plant that was mentioned is for, I think, destination China, but it is for the  
31           scouring of fine wools.

32   **COMMISSIONER GALE:** Do you have a figure for the cost of a Cardmaster plant, the  
33           3-metre?



1 **MR CARADUS:** \$5 million, just for the plant.

2 **COMMISSIONER GALE:** 5 million US?

3 **MR CARADUS:** No, NZ. But that's only part of it.

4 **COMMISSIONER GALE:** That's the stainless steel stuff is it? I mean, not the building of  
5 the --

6 **MR CARADUS:** You need a press and you need motor control and you know, there's a lot  
7 more.

8 **MR DWYER:** But the ancillary equipment would come to nearly \$5 million also, wouldn't  
9 it, if you add it all up?

10 **MR CARADUS:** It would be closer to 8, I think, yes.

11 **COMMISSIONER GALE:** Thank you. There was one other --

12 **MR HALES:** Yes, I'd just like to respond to some of the questions about the different types  
13 of scours. I think Cavalier are probably in the best position to do a benchmark  
14 between the different types of scours. Simply, we are the only company in  
15 New Zealand that's running 2.4-metre wide scours and 3-metre wide scours. So we've  
16 got an everyday example of the costs of running them, so we know them absolute.

17 Secondly, the scour types that we have in New Zealand are quite different, and  
18 they're not all Cardmasters, as is suggested. In fact our scours in the South Island are  
19 very, very close to being Topmasters, and the difference between a Topmaster and a  
20 Cardmaster in some cases can be very insignificant, and it can be right down to the  
21 opening practices, or the number of bowls.

22 In fact, if you benchmark the 3-metre scour that Canterbury Wool Scourers  
23 has, and the two scours that were sold out of Western Australia to TNU, there is very,  
24 very different - there is very little difference physically in those scours.

25 With reference to the dryer issues, yes, we had a manufacturing dryer problem  
26 for about six months, might have been even closer to 12 months. It was a nightmare  
27 for us. It was a problem with the dryer, and it took us some time to get over it, and in  
28 the end, we modified it ourselves to get around the original manufacturer's  
29 specifications. It is my understanding that there are other dryers in the country  
30 operating now that haven't had the same modifications.

31 **MR HEATH:** Cliff Heath, Wool Equities. Just further, I think one of the issues, I think you  
32 haven't put enough emphasis on the resource consent issues. I've spent 12 years as a  
33 district counsellor and three of them as a deputy mayor, and I have seen a fair raft of

1 resource consents come through and I'd have to say that I'm a Progressive, that it's a  
2 lottery as to whether they're granted or not.

3 Given you've got discharge to the air and discharge to water, or discharge to  
4 ground, the chances of getting them and getting them easily is underestimated. All  
5 you need is one irate person who can hold up the process, literally for years.

6 So to believe that you can just find a site that yes, it may well be consented as  
7 to use, but is it going to be consented as to discharge to air because that will be the  
8 critical one, and all you need is a neighbour who decides, no, I don't like it, and they  
9 can hold you up.

10 So it's a lottery. It's not a foregone conclusion that you've found a site, you can  
11 build.

12 **COMMISSIONER GALE:** Thank you. I think we have had a few submissions on sites and  
13 sites that could be reused and the difficulties of getting new sites going.

14 **MR WHITEMAN:** Peter Whiteman from Segard Masurel. We are wool exporters, part of a  
15 global wool trading company. At the moment, we have operations in five countries  
16 around the world, including South Africa, where we own our own wool scouring and  
17 top making.

18 Today, we have the volume in New Zealand, we turn over the volume of  
19 scoured wool today to run a 2.4-metre plant ourselves, and we have the financial  
20 capital to build a plant ourselves. All that to say we don't want to, we have no desire  
21 to, but we have the capacity and volume capital and expertise to build a plant.

22 **COMMISSIONER GALE:** How much provocation would you need?

23 **MR WHITEMAN:** Not much. No, that's impossible to answer, sorry.

24 **COMMISSIONER GALE:** Yes, okay.

25 **MR GEORGE:** Could I just add one more on the resource management environment issues.

26 I don't have the paper here, but we took specific advice on that as well and actually, I  
27 think the law change that talked about may have come in. There used to be - and that  
28 isn't my area, I can go and check it if you like - a local Council process that to go to.  
29 Apparently, there is or was at the time, and apparently is now, a parallel process for  
30 something like important or essential industries to apply through that actually doesn't  
31 go through a Council, but goes through a different body, the environmental - I'll get  
32 the --

33 **COMMISSIONER GALE:** I would repeat to converse on that.

1 **MR GEORGE:** Yes, sure. So I think the law has changed, effectively.

2 **MR HEATH:** I wouldn't have thought it was a big enough deal to get into that process.  
3 You're talking about major projects, sort of hundreds of millions, not you know, 10,  
4 \$12 million here.

5 **COMMISSIONER GALE:** Can I ask the economists, first of all, whether it's agreed that  
6 entry is the relevant constraint as opposed to sending wool to China for scouring and  
7 coming back, just because all estimates seem to be that the cost of entry is less than the  
8 cost of sending wool to China and trying to get it back.

9 So apart from the China constraint itself, is it agreed that entry is the relevant  
10 thing we should be assessing? And I wonder if NERA, Mr Mellsop, in general terms,  
11 do you have comments to make on the Futures calculation of the entry price?

12 **MR MELLSOP:** Thanks, Dr Gale. On the first question, my instant reaction was it's the  
13 China constraint. But if I understand your question, leaving that aside, is it a China  
14 and bank versus entry, which comes first?

15 **COMMISSIONER GALE:** Yes.

16 **MR MELLSOP:** I'm not sure I know. I haven't sort of thought too carefully about the  
17 relevant costings. But personally, I've always seen the main constraint here to be  
18 people exporting greasy wool to China and that's because of the lack of price  
19 discrimination, which no doubt we'll get onto. It seems to me to be the binding  
20 constraint here. Entry versus sending it there and back, I don't know, I just don't have  
21 a --

22 **COMMISSIONER GALE:** I guess the customer to have in mind is Godfrey Hirst.

23 **MR MELLSOP:** I'm aware that they've said it's prohibitive. I don't have any reason to doubt  
24 that.

25 **COMMISSIONER GALE:** Okay. So going to the entry cost calculation, have you formed  
26 a view yourself as to what the entry price might be?

27 **MR MELLSOP:** I haven't done my own model. I have looked at Brent Layton's model, and  
28 a lot of this is confidential so I'm sure we'll deal with it on Friday. But I can make a  
29 couple of points.

30 I think the difficulty with it, in summary, is it's not broad enough. I think that's  
31 probably illustrated by the discussion about operating losses in the short term, and how  
32 that might be expected. Brent's model is a single-year model and does assume revenue  
33 straight away, full revenue straight away. So if I was starting from scratch, I would do

1 a longer-term NPV model, I guess, would be the better way to do that. So I think  
2 that's one concern with relying on it.

3 There are a variety of other issues with it, I think. One I think has already been  
4 notified by Bell Gully as being the WACC issue, because Brent's report talks about a  
5 pre-tax WACC of 15 percent, yet he's actually used 20.83 percent, and we think it's  
6 because he's actually grossed up 15 percent by the tax rate of 28 percent. So, you  
7 know, he's actually applied the wrong WACC, or a different WACC, to what he said  
8 he would in the main report, which of course increases the required revenue.

9 There's few entries in the columns there which I'm not in a position to judge,  
10 and Jim Drake will give a far better view on these things, the appropriateness of the  
11 cost lines. But the one that jumped out to me is there is effectively a second layer of  
12 management, a second CEO. There's actually two lines for CEOs, in effect. I'm not  
13 sure if I should mention the number here, but it's a very large number.

14 So if one puts the WACC at 15 percent that Dr Layton said he used, if you take  
15 off that second CEO, CFO, that particular line, and as well as there's few minor things  
16 which weren't in the Awatoto 2.4-metre column, but Dr Layton has added without  
17 explanation, and once again, I can't judge the appropriateness, but it does seem a bit  
18 odd. But if you do that, you actually get pretty close to a zero percent differential as  
19 opposed to a 40 percent.

20 And it doesn't take a lot of reduction with \$13.5 million capex figure he uses to  
21 suddenly be at zero percent, and I know that that figure is disputed by Cavalier. Once  
22 again, I can't comment on the appropriateness of the figure.

23 So I guess in summary, I think we need to be very careful. It's dependent on a  
24 couple of quite key assumptions which are disputed factually.

25 **COMMISSIONER GALE:** Yes, we'd be interested in seeing your attempt at a calculation,  
26 if that's possible.

27 **MR MELLISOP:** Yes, I'm sure I can have a go.

28 **COMMISSIONER GALE:** Ms Branson, are you close to this calculation?

29 **MS BRANSON:** In this session, we can't go into details about the numbers, but I would like  
30 to reinforce your latest point there.

31 Because this calculation hadn't been done, Brent went out and got the best  
32 information he could obtain in the time available. He's had people in the industry  
33 check this to verify and validate that he's using appropriate numbers, and he's put all of

1 this forward and the supporting data that he's used, because there wasn't anything  
2 there. So in reinforcing your earlier point, the onus of proof now is surely on the  
3 applicant to come up with some better numbers.

4 To address one of the points that NERA raised, the suggestion that Brent's  
5 analysis is not broad enough, that he had a single-year model and was assuming  
6 revenue straight away, that will surely - is erring on the side of new entrants being  
7 more likely rather than less likely. So he's being conservative in his assumptions.

8 **MR MELLISOP:** And I'm not disputing that. I'm just pointing out the model is not one that I  
9 think we should rely on because it's a single-year model. So I agree that that actually  
10 pushes it in that direction, yeah.

11 **COMMISSIONER GALE:** Godfrey Hirst.

12 **MR PIKE:** Can I just make one point regarding the estimate of the cost of processing wool  
13 in China, and I make it from the point of view of Godfrey Hirst and all New Zealand  
14 and Australian manufacturers.

15 That point is that it's a theoretical exercise only, because it's not possible to  
16 process wool in China at present because we haven't been able to find any means of  
17 pressing the wool to make it cost-effective to ship it back to New Zealand. There  
18 simply isn't the machinery over in China to do it.

19 That's not saying that they can't do it in the future, but what we're saying is that  
20 that machinery is not there now and we can't see the Chinese manufacturers racing to  
21 install it either.

22 **COMMISSIONER GALE:** So your fall-back is doing it yourself, rather than hoping that  
23 the China thing will come together?

24 **MS PAULING:** Or you move all of your production to China, because I mean, the scouring  
25 cost, as we've all acknowledged, is a small part of the overall cost, but we have to get  
26 it done. So if we can't get our wool scoured here on time to the quality that we need  
27 without the risk of getting bumped down the chain or plants being shut, we really have  
28 to look at whether we move our more expensive processing parts of our business to  
29 China with the wool.

30 So that means we wouldn't be buying New Zealand wool, we wouldn't be  
31 making yarn here and we wouldn't be making carpet here, and that's a real risk for our  
32 business.

33 **MR HEATH:** Mr Chairman, that, I believe is the real risk to the sheep farmers of

1 New Zealand, that if Godfrey Hirst was to withdraw, the impact on the country, the  
2 country's economy, would be significant. And whilst they are the biggest player, there  
3 is a submission here from Christchurch Yarns which is basically saying the same  
4 thing, and there are a number of others and there are little companies which we, as  
5 Wool Equities, as farmers, are working with to try and build.

6 Their very future is at risk if we have to totally rely on Cavalier and Cavalier  
7 decide, when they became the gate keeper for the industry, that they do not necessarily  
8 want to see us survive. I believe it's the gate keeper role that Cavalier Corporation will  
9 hold coming out of this that is the real danger to the rest of the wool industry. That's  
10 significant.

11 **MR SUNDAKOV:** Perhaps just if I can comment on your question, coming back to the  
12 significance of what kicks in as the limit. I think it's very important here to distinguish  
13 between what I would call export parity and import parity. Export parity is the choice  
14 between shipping greasy wool and processing in China versus processing in  
15 New Zealand and shipping it for export, versus processing in China and bringing it  
16 back to New Zealand for use in New Zealand. Now, I think that to the extent that it's  
17 possible to get kind of a sense of what the costs would be, it seems to me that the  
18 export parity kicks in before entry would occur.

19 So in other words, if the choice is to enter and build a new plant in  
20 New Zealand, if you're an exporter, or to ship greasy wool and process it in China, it's  
21 much more likely that the cap will be processing in China. It's only for re-import  
22 purposes and for use in New Zealand that entry could be a barrier - entry could kick in  
23 first.

24 But that's an important consideration because what that means is that the  
25 demand for that new entrant plant would be limited by their own use of the  
26 New Zealand manufacturer other than Cavalier. In other words, it will be very  
27 difficult to get the scale economies because you couldn't, at those costs, compete with  
28 processing for export.

29 **MR GEORGE:** Can I also say, just again from the investment perspective looking at this,  
30 we very much looked at the risks of both either Godfrey Hirst or Cavalier leaving the  
31 country, and for various reasons, we went through that analysis. Godfrey Hirst is  
32 privately owned and Cavalier is a public corporation and you don't know what could  
33 happen.

1           They're both large businesses and there's a possibility of being purchased by  
2 off-shore groups if they were put on the market. So it was an issue that exercised us a  
3 lot. And it is, it's just one of those industries that is probably continually under review  
4 for its location, like all other industries. But the other issue for us in looking at if,  
5 assuming they did stay, the bigger for us and for the sheep farmers is actually the  
6 threat of synthetics moving into the carpet industry.

7           So, you know, we are specifically interested in wool only, we're not interested  
8 in carpet. So we've got a real issue and we're joined at the hip with sheep farmers on  
9 that as well. We don't mind whether carpet goes up or down or how price competitive  
10 as an export; we do care how much wool goes into the carpet. So I think there's lot of  
11 emphasis on making sure our costs remain competitive and our quality remains good.

12           But our analysis is if that were to happen and synthetics did move in,  
13 New Zealand does have special wool and it is sought after and it's sought after at the  
14 quantities that we can supply, and we had always hoped that if either of those two left,  
15 we would still have a scouring industry here because we could supply - we've got  
16 special wool and we've got good scouring techniques and qualities and we thought that  
17 the scouring industry could potentially survive that, but it would be incredibly tough.

18           I think the other issue is with wool and carpets as well. The price of wool has a  
19 massive impact on how much wool goes into a carpet or not, and it's not really the -  
20 well, the scouring component can be a very small portion of that or a large portion  
21 depending on how much the wool price moves. But when you look at the increase in  
22 wool over the last year, I don't know, but you can just logically expect that the carpet  
23 manufacturers are looking at substituting us for other products.

24           We have no control over that, except to market ourselves and keep our costs in  
25 line as best we can.

26 **COMMISSIONER GALE:** Thank you.

27           Ms Pauling, can I just ask you, or go back to your comment about the fate of  
28 the carpet industry. I understand that scouring is a small part of the wool price and  
29 presumably an even smaller part of the cost of carpet manufacture. Is it credible that a  
30 40 percent increase in the price of scouring could kill off New Zealand manufacturer  
31 of carpet?

32 **MR PAULING:** Carpet, and Wayne will confirm this, is driven by volume. We have to fill  
33 our plants, particularly the yarn plant. At the moment, we're going through recession.

1 As Ross has said, we're competing with synthetics that are really, really  
2 price-sensitive.

3 We are careful of every single cent in the pricing of our carpet, and at the  
4 moment, a 40 percent increase in scouring would have an impact. It's not going to  
5 send us off-shore to China, but we are having to compete with a changing mind-set of  
6 New Zealand consumers around buying wool carpet.

7 We've seen a drop in our business of, 82 percent wool carpets, I think six years  
8 ago, to now 65. So the pricing around everything when it comes to wool, particularly  
9 with the wool prices going up, is incredibly sensitive. So we have to be mindful of  
10 every single input cost into our product. That's always been the advantage that  
11 Godfrey Hirst has had, because we have a very flat structure, we don't have a lot of  
12 overheads and we fight for every single cent.

13 We can't afford to be in a position where our wool is not able to be processed,  
14 never mind the cost, because of risks to there being only two plants, one in the  
15 North Island, one in the South Island.

16 So that has always been a greater concern to us than the cost, but the cost is  
17 obviously a component of our concern, and we don't know what they can do. I mean,  
18 we have a good working relationship with them as people who process our wool, and  
19 they do a good job. But as you say, where is the line going to be drawn in the future in  
20 terms of how far it can be pushed?

21 **MR CHUNG:** I just want to make the comment that in the factual, Cavalier Wool Holdings  
22 will have a substantial investment in the scour business, and it's very volume-driven in  
23 terms of its earnings, so it actually needs those volumes, so it's absolutely essential that  
24 we stay on-side with every customer, particularly Godfrey Hirst being virtually the  
25 number one customer in terms of mill wool.

26 It makes absolutely no sense for us to disappoint them in any way in terms of  
27 service levels. So I know at the moment within our scours, we've yet to disappoint  
28 them, and we certainly won't in the factual situation, because of the importance.

29 **COMMISSIONER GALE:** Thank you. Well, China has sort of come up as a - okay.

30 **MR CARADUS:** I'd just like to confirm the price that I gave for if we had to establish a new  
31 plant and taking into consideration all the factors, it comes out at \$21 million for a  
32 3-metre.

33 **COMMISSIONER GALE:** Land, buildings, equipment?



1 **MR CARADUS:** Yes.

2 **MR WEINSTEIN:** My name is Steve Weinstein, I'm the President of Michell USA,  
3 Nexpoint LLC. I've scoured about 20 million kilos in New Zealand since 2003/2004,  
4 and I'd like to make a couple of comments.

5 Michell, which is an Australian-based company, has lived through the  
6 consolidation of scouring and processing in Australia, I've seen it firsthand. We still  
7 maintain a scouring and carbonising unit in Adelaide. We now have a plant, Suzhou,  
8 in China that does have the ability to ship 450-kilo bales to wherever in the world,  
9 which would include New Zealand if that was a possibility.

10 The second point I'd like to make is regarding bringing wool back to  
11 New Zealand which currently goes out of the country in greasy form. There is  
12 definitely potential for major brands around the world to actually look at a transparent  
13 model, whereas instead of taking greasy wool and shipping it to China and scouring it  
14 and even making it into a top, making a more transparent model whereas you could  
15 scour the wool in New Zealand and send it to a dry combing mill somewhere else in  
16 the world.

17 And showing the transparency of New Zealand in the benefit of having a  
18 country that is concerned about carbon footprint, those companies have in their retail  
19 brands prices in the marketplace which would support higher scouring prices if that  
20 were to be the case.

21 So there are other brands around the world, major brands, that are looking at  
22 carbon footprint and look to New Zealand and would prefer New Zealand as a  
23 destination to use in their marketing for scouring their wool. I would support, even  
24 though I've scoured at various places in New Zealand, a new scourer in New Zealand  
25 if one gave me a reason to support them, if it was a new entry into the marketplace.

26 I'm not beholden to anybody to scour the wool, it's the retail brands around the  
27 world other than the domestic industry which is very vital, and I'm here to support the  
28 domestic industry in New Zealand. But there's global brands that look at New Zealand  
29 as a mecca for environmental issues and as a green country, and they want the  
30 transparency of taking their wool and scouring it in this country and then putting it  
31 through the system globally. So I just wanted to add those two points. Thank you.

32 **COMMISSIONER GALE:** Yes, that's like a relatively new idea, so if people have further  
33 thoughts about that, they can let us know.

1 I think China has sort of crept into this analysis in bits and pieces, but now we  
2 should focus in particular on the wool that's exported to China and other places, and  
3 the pressure that that wool might go off-shore greasy rather than being processed and  
4 being scoured here, and what limits that might impose on Cavalier. Sue Begg's going  
5 to provide some questions.

6 **COMMISSIONER BEGG:** We've already discussed the option of exporting wool to China  
7 and getting it scoured there and bringing it back, so I won't ask any further questions  
8 on that. But one option that we haven't heard much about today is the option of  
9 exporting wool greasy for scouring in China, and then that being re-exported to other  
10 markets like Europe or the US.

11 In submissions, we have had comments about the potential cost of that; I think  
12 there was an estimate which I think was from Futures, that that would require an 80 to  
13 90 percent price increase. We've heard from others who are concerned that that would  
14 involve the loss of control of the quality of the wool and the cost of ensuring that, in  
15 the process of scouring in China, we ensure that it's New Zealand wool that is on-sold  
16 and that the quality is kept up.

17 But I would just be interested in comments on at what point would this option  
18 of scouring in China for other markets become a real constraint. I just note that we  
19 have been told that there are some examples of it happening already. One example is  
20 in fine wool with Icebreaker, where New Zealand wool is exported to China for  
21 scouring and then it comes back to Fiji for processing, but that's just one example  
22 which is obviously of interest, but probably not very definitive. So yes, I'd be  
23 interested in comments on this issue.

24 I wonder if anyone - perhaps we'll start with Godfrey Hirst, if they've got any  
25 thoughts?

26 **MR PIKE:** Could I just make one comment regarding the Icebreaker example and that is that  
27 it's my understanding that the wool is exported to China, but it's not just scoured there,  
28 it is further processed as well. I thought it was simply the final manufacturing that was  
29 undertaken in Fiji, which would be the assembly of the clothing from the fabric.

30 So what we have in China in the Icebreaker example is the scouring of the  
31 wool, the spinning of the wool into yarn, and the conversion of that yarn into fabric.  
32 Scouring is just a small part of that cycle.

33 **COMMISSIONER BEGG:** I wonder if any of the merchants or John Marshall or Wool

1 Equities have got any comments?

2 **MR CRONE:** That's quite correct. That is what does occur, the assembly of the fabric takes  
3 place in Fiji.

4 **COMMISSIONER BEGG:** What about other examples of whether this option provides a  
5 constraint for other markets?

6 **MR CRONE:** To re-export to other markets?

7 **COMMISSIONER BEGG:** Yes.

8 **MR CRONE:** I mentioned before the bureaucracy that exists and the constraints that that  
9 will impose will just make your timelines and your carrying costs just totally unviable.

10 For example, inadvertently a container got transferred from Shanghai up to  
11 another port, and it took us three weeks to get it returned to Shanghai. Now, it was the  
12 shipping company's problem, but the bureaucracy that followed just made it  
13 impossible. The re-exporting, well, you'd have absolutely no control. It's one of the  
14 reasons we scour with Kaputone, is that we have total control over what we do.  
15 Quality-wise, we can visit the plant easily. If you're short of wool, you can deliver  
16 easily. It just imposes far too many constraints in your day-to-day operations.

17 **COMMISSIONER BEGG:** Is there a price increase that would change your view on that?

18 **MR CRONE:** No. It's not really a price increase at all. It's quality control. And that's what  
19 New Zealand companies in general have built their reputations on, is quality control.  
20 You would certainly lose all that.

21 **COMMISSIONER BEGG:** Okay. Wool Equities?

22 **MR COWAN:** In my past life, we did two lots of wool up into China from New Zealand.  
23 One was scoured here and taken to China and made into baby clothing, and we ended  
24 up with it contaminated with mattress wool from South America and dog hair and  
25 other things, and we were a bit disappointed that that was the end result of that. That  
26 was not a scouring experience here. The scouring here happened fine.

27 The second one was actually some wool which we shipped to the Michell's  
28 plant in - wherever it is, Suzhou, and we had it scoured there and it was processed as  
29 well as we could expect. I think it was fine. But at the time of me leaving H Dawson,  
30 it had been sitting there for 12 months and we hadn't been able to move it along from  
31 there, either to re-export it somewhere or to move it within the Chinese country itself.

32 So it is problematic and H Dawson had seven staff based in Beijing who were  
33 quite capable of doing all the export documentation associated with it as well, but it

1           wasn't just a simple process of putting wool in and then pulling wool out again.

2   **COMMISSIONER BEGG:** I think your submission might have mentioned Sunrise Bedding  
3           Wools, is that correct? I wasn't quite sure what the point was being made in the  
4           submission, but it talked about contamination of the wool.

5   **MR COWAN:** That was it.

6   **COMMISSIONER BEGG:** That was the one, okay.

7   **MR WEINSTEIN:** I'm a vendor to Smartwool. I actually take New Zealand top, which is  
8           processed in China, which is shipped to Mexico, where I have a partner in Mexico, I  
9           make that into yarn which then goes to North Carolina to be made into a sock. We  
10          have been in that process for the last six years, successfully operating that, and that's  
11          one of the people that I'm trying to convince in a transparent model to maybe scour  
12          their wool in New Zealand and then send it to China to be dry combed and finished.

13                 So there is a global model for not only Icebreaker, but for New Zealand wool  
14           going through China into my system, which I've been operating successfully using  
15           New Zealand merino top which is very well-received in the marketplace, part of  
16           Smartwool's marketing. So I do have experience and knowledge and the last six years  
17           has been going very well.

18   **COMMISSIONER BEGG:** So you don't have these concerns about the quality of the  
19          scouring in China?

20   **MR WEINSTEIN:** No, I have no concern. We've had not one quality issue. We've had  
21          maybe one regarding some after-curing of top which happened once in the last six  
22          years, but we've had very good luck utilising New Zealand top, or New Zealand wool,  
23          that's combed in China and brought back to Mexico to facilitate spinning and knitting  
24          in North Carolina to be made into a final sock, which is then branded by Smartwool  
25          which is owned by Timberland.

26   **COMMISSIONER BEGG:** And your suggestion to bring the scouring back to New Zealand  
27          is a branding issue to do with some environmental --

28   **MR WEINSTEIN:** Yes. I prefer, for carbon footprint purposes, when you ship greasy wool  
29          that has a yield, let's say merino would have a yield of 72 percent, you're shipping dirt  
30          and grease to China. So by shipping scoured wool from New Zealand, you have close  
31          to a 100 percent yield clean wool going into a container which actually lowers the  
32          basis price of shipping to China, and then it can be converted into top super-washed  
33          and sent wherever.

1 Michell, the company I work for since 1985, has a plant in Malaysia and we're  
2 actively looking at scouring wool in New Zealand as part of our branding exercise and  
3 environmental and carbon footprint, and your concern about the environment, which  
4 goes very well in marketing in the United States, I can tell you.

5 We're looking at scouring, the basis for us would be scouring in New Zealand  
6 and shipping it to whoever has a global supply chain and Smartwool happens to have  
7 one which is successful, a virtual company, they don't own brick and mortar. Yes, if  
8 that answers your question, I have no problem with that.

9 **COMMISSIONER BEGG:** Thank you.

10 **MR DEAKINS:** Geoff Deakins, Financial Controller, New Zealand Wool Services  
11 International, over 25 years' experience in the wool industry in the financial field.

12 Just on that last speaker, one of my other colleagues here will speak to it in a  
13 minute, but I think it's very important to identify what he's saying and what segment of  
14 the market he is talking about. From what I picked up, he's talking about the fine wool  
15 market. I don't think that's really a major issue here today. I think we're here to talk  
16 about the coarse wool market, where the bulk of Wool Services' business and  
17 New Zealand wool business is. And I think that can be talked about shortly.

18 But just going back to your point earlier on, and you started off by identifying  
19 that appendix A in the Futures presentation identified a figure of 90 cents as an  
20 example of the cost of shipping wool to, for instance, China and then on to Europe,  
21 and I concur with that. Those figures are correct.

22 But in confirming also what Peter Crone has said, it's not really the issue of  
23 what that cost is, it's simply that a wool exporter in New Zealand would not consider it  
24 in any shape or form. And I think the major reason behind that is that this is a  
25 business that is of high value and everything sold is quite a lot of money.

26 Now, where I'm getting to is that for us to ship wool to China and then try and  
27 ship it to another destination that we've sold it to, is going to double the time that we  
28 own that wool. Quite simply, it would not be possible for us to continue our other  
29 business while our cash flow is clogged up with wool we own for twice the time that it  
30 needs to be. The effect of that would be that we could not sell to other parties because  
31 we haven't got the facilities to do it. It's just a no-goer.

32 I don't really think the figures, while they are correct, are the key issue. The  
33 key issue is a wool exporter could not do that. They haven't got the facilities to do it.

1 But I'd also like to come back, and I think just to make sure we're quite clear on the  
2 issue of fine wool and coarse wool.

3 **COMMISSIONER BEGG:** It's interesting, the two examples we have seem to be of fine  
4 wool. I'll just get a response from there, and I'll come to Cavalier.

5 **MR WEINSTEIN:** If I could just clarify, the 20 to 24 million kilos that I have scoured in  
6 New Zealand since 2002/2003 has been cross-bred Romney wool, some Perrendale  
7 wool, but it has not been fine wool. I have scoured no fine wool in New Zealand. I  
8 would like to, but the wool that I've scoured and referred to as 20 to 24 million kilos  
9 since that time has all been cross-bred wool.

10 **COMMISSIONER BEGG:** Cavalier?

11 **MR HALES:** I'd also like to make the point that the fine wool sector in New Zealand is a  
12 very important part of the sector. We certainly would never overlook the needs of the  
13 fine wool sector here. We've actively put Topmaster style scours in the South Island  
14 to cater for merino needs, we are the only capable, truly capable merino scourer in  
15 New Zealand, and we want the merino growers to be well-serviced in New Zealand.

16 **COMMISSIONER BEGG:** Okay. Thanks.

17 **MR HEATH:** One of your parameters is to in fact look to public benefit. Clearly, the  
18 greatest public benefit to New Zealand as a whole is to do as much on-shore  
19 processing as possible. Clearly, the most benefit we would get if every ounce of wool  
20 that ever left here was actually spun or made into a product. So to actually be  
21 contemplating sending more product in a raw form is actually not public benefit; it's  
22 actually the contrary.

23 **COMMISSIONER BEGG:** We're trying to just get a feel for what the constraint is so that  
24 we can calculate the detriment that might happen if this took place.

25 **MR HEATH:** Okay. Thank you.

26 **COMMISSIONER BEGG:** Yes, so not suggesting that's a good model, but just trying to get  
27 a good feel for what the constraints would be.

28 **MR HEATH:** I thought that was where it was drifting to.

29 **MR DEAKINS:** Just to clarify my point, that's exactly what I'm saying, is that there is the  
30 constraint of shipping wool to China and other destinations, it's not possible, there is a  
31 major constraint.

32 **COMMISSIONER BEGG:** I'd like to move now to the wool that is exported to China for  
33 use in China. At the moment, we have both clean and greasy wool going to China for

1 processing in China. I was just interested in people's comments on why it's not all  
2 one, all greasy wool, all wool goes greasy, or all wool goes clean to China. What  
3 results in this being a mixed situation? I wonder if anyone would like to lead off on  
4 that, whether they have any thoughts on what's causing this balance.

5 **MR HALES:** I'm sorry, could you repeat the question?

6 **COMMISSIONER BEGG:** Sorry, I made it more complicated than necessary. We have  
7 clean wool being exported to China and for use in China, we have greasy wool being  
8 exported for use in China. I just wondered why it wasn't the case that it was all wool  
9 was going greasy or all wool was going clean. Why do we have that mix, which  
10 seems slightly unusual.

11 **MR FERRIER:** David Ferrier. I can respond to that maybe in part. Our organisation, and  
12 one or two others in New Zealand, have proactively over the last 15 years been  
13 working towards a situation that we have today where because we have sufficient  
14 critical masses in the size of the residual participants, we've continued to make  
15 scouring a viable and hopefully as attractive as it can be a proposition.

16 Had we not been so proactive and Godfrey Hirst and a number of others have  
17 played their role there, we may well have had the sort of situation that's happened in  
18 other countries. I remember sort of 10, 12 years ago observing it, wondering why  
19 weren't they reacting, why weren't they getting their costs into such a critical mass that  
20 they could share those to the benefit of the parties they were providing the service to.

21 So I think in part the answer is the amount is - it's easy to send greasy wool to  
22 China and say, look you guys do it, and the prices may be to some degree cheaper, but  
23 by virtue of us doing what we have done, we've made it attractive to keep the ratios,  
24 and to some extent to fly in the face of what logic would have it; it's machinery, it's  
25 heavy industry, do it in China, China does all of these sort of things better at the end of  
26 the day.

27 It's not like it's a new thing for them to be doing, they've been doing it for a  
28 long time. So I think in part that might answer your question.

29 **COMMISSIONER BEGG:** Okay. Maybe I can put it another way, which is we have the  
30 wool that's going greasy to China. Now, what we have to do to win it back and why  
31 isn't that possible, as some people suggest?

32 **MR COWAN:** In New Zealand, if you're exporting New Zealand wool, it has to be  
33 100 percent New Zealand wool or else it has to be noted on the export certificate that it

1 isn't New Zealand wool. If you send New Zealand wool to China, then they can dumb  
2 it down by blending it with any other type of wool, and the best time to do that is at  
3 scouring, and so you can dumb it down and you can end up with New Zealand wool  
4 that's of vastly less cost than the New Zealand scoured and New Zealand 100 percent  
5 sourced wool.

6 In the UK, to export British wool, British wool only has to have 50 percent  
7 British wool content in it and the rest can be anything you like. So what actually  
8 happens in England is that Chinese wool gets shipped to England and Libyan wool and  
9 wools from many Mediterranean countries, France etc, and it all gets blended in and so  
10 long as there's a 50 percent British wool content, that can be exported as British  
11 scoured wool.

12 So I think that's probably the major reason why some people take greasy wool  
13 to China, so they can contaminate it and still call it New Zealand wool.

14 **COMMISSIONER BEGG:** At the back there?

15 **MR WHITEMAN:** Sorry, Keith, I have to disagree wholeheartedly with you about that.

16 The major reason New Zealand wool goes greasy is we're selling to basically big  
17 companies in China who have their own scouring, they have their own top-making and  
18 spinning and yarn and they want to do the vertical process themselves. They buy wool  
19 from many other origins, there's no dumbing down of it at all, they make a high quality  
20 yarn and product, but they have the capacity to do everything themselves so they want  
21 greasy wool; it's about as simple as that.

22 **COMMISSIONER BEGG:** But is there some situations where people do want to blend  
23 New Zealand wool and therefore with other wool, for whatever reason, and therefore  
24 that probably has to be done in China? Would that be correct?

25 **MR WHITEMAN:** Yes, sure. No, it doesn't have to be done in China, and all this China  
26 talk, we're getting a little bit wound up in China. You know, there's India, there's  
27 Eastern Europe, this is not just a China thing at all. It's just China's been labelled as  
28 the model, if you like. But this sort of thing happens in the wool industry all the time.  
29 It's been the basis of the wool industrial for many years.

30 **COMMISSIONER BEGG:** So would blending of non-New Zealand wool ever occur in  
31 New Zealand? Do people import --

32 **MR WHITEMAN:** Yes, it does happen in New Zealand, yeah. It comes into New Zealand.  
33 It must be re-exported and there's quite a process to go through - no, it doesn't actually



1 in the end, but there's quite a process, but there is a certain quantity of foreign wool  
2 coming to New Zealand, blended and processed here, yep.

3 **COMMISSIONER BEGG:** Okay. Thank you.

4 **MR DWYER:** I would say that the quantity of wool being imported into New Zealand for  
5 blending is minute, to say the least. I think that in the China market, in terms of greasy  
6 wool shipped from New Zealand, it is for blending, it is for cheapening down the more  
7 expensive wools from Australia or elsewhere and they do need the components, the  
8 New Zealand componentry, to make their blends and they are going into high-quality  
9 product and they are, as Peter said, to big manufacturers who have their own scouring,  
10 who have their own top-making and the type of wool we're talking about is principally  
11 destined for top-making. That's the important thing. That's the greasy wool side of it.

12 In scouring, and I can talk from authority on this, as we have over 50 percent  
13 of the scoured wool market in China, a lot of our product is being sold to top-makers  
14 as well. A big portion of the New Zealand import from China is for top-making. The  
15 reason that they buy scoured wool from New Zealand is because they're buying  
16 assured quality products, particularly from WSI, and we've developed a branding  
17 strategy in China called red band which is a guarantee to the manufacturers of quality  
18 and quality product.

19 They are now preferencing, wherever they can, scoured New Zealand wool  
20 against greasy New Zealand wool. So the trend, actually, and I will give you this later,  
21 is strongly in favour of scoured wool at the present moment.

22 **COMMISSIONER BEGG:** So of the wool that goes to China greasy, what would be the  
23 scope for winning that back to being scoured in New Zealand, in your view?

24 **MR DWYER:** Sorry?

25 **COMMISSIONER BEGG:** The wool that currently goes greasy to China, how much of that  
26 could be scoured in New Zealand? Could we win it back?

27 **MR DWYER:** That's a very good question and I really cannot answer that one. I don't know.

28 **COMMISSIONER BEGG:** Any other comments on this?

29 **MR WEINSTEIN:** Steve Weinstein, Michell. Yeah, just commenting on can it be won  
30 back. I don't think there's been any effort to win it back. I've taken it upon myself and  
31 my company in America, because I love New Zealand and I love the industry here,  
32 and I want to support particularly the scouring industry at the very least since there is  
33 no combing here, I think there should be an effort and I'm trying to make an effort

1 myself to bring business back to New Zealand for scouring. I don't think anybody's  
2 actually tried.

3 I'm just one person in the United States with a small company, pretty big  
4 turnover, but it can be won back. It just takes a little temerity and some hard work and  
5 bring people down here so they understand what scouring is. A lot of the international  
6 brands don't even know what scouring is. So I think it can be won back for  
7 New Zealand, if you give it a go. Thank you.

8 **MR DWYER:** I'd just like to respond to that. What this gentleman is talking about is the  
9 carpet wool market, in carpet wools going to China. The majority of New Zealand  
10 wool going to China is scoured for the carpet industry in China. So I don't think  
11 there's much to be won back.

12 **COMMISSIONER BEGG:** Okay. Just, then, in terms of the wool that goes clean to China,  
13 there's been a bit of a debate in the submissions as to the capacity of the Chinese  
14 industry to scour that wool. There's some suggestion that they're focused on fine wool  
15 and their scours are oriented towards that, but we've heard contrary opinions that  
16 there's plenty of capacity for scouring our wool there. In fact, there's over-capacity in  
17 China at the moment. So I just wondered if anyone had any comments on the capacity  
18 of China. Cavalier?

19 **MR HALES:** Yes. The Chinese capacity is enormous. In fact, we've done a market survey  
20 recently which we've provided to the Commission, and we've got to over 100 scouring  
21 sites and we believe there's a lot more. The scouring sites cover a full range. Even if  
22 you look at China themselves, are the second largest producer of wool in the world  
23 behind Australia and it covers all micron types quite equally; fine, mid-micron and  
24 coarse wool.

25 There appears to be specific regions and there are specific regions where there  
26 are massive amounts of wool scours that are servicing the carpet industry in China.

27 **COMMISSIONER BEGG:** Any other comments on that? I just wondered if people had a  
28 view on what sort of price rise would result in the loss of the wool that's scoured in  
29 New Zealand to China, the wool that's used in China? We've had suggestions that the  
30 costs are reasonably in balance, I think Futures suggested that China is marginally  
31 more expensive, but given that some wool is already scoured there, it must be close to  
32 balance. But what would trigger the rest of the 14 percent to go to China greasy?  
33 What sort of price? Do people have a feel for that?

1 **MR DWYER:** I think one of the factors influencing the shipment of greasy wool to China as  
2 well as what would - trying to answer your question, grease extraction is a very  
3 important component, and New Zealand greasy wool - I'm talking about the coarse  
4 wool now - yields about anywhere from 1 and a half to 3 percent, whereas the fine  
5 wools like merinos, we're talking 6, 7, 8 percent.

6 Now, this is worth liquid gold today. It's a huge price, and in actual fact, for a  
7 lot of the mills in China, it's their main source of income; not a charge-out on actual  
8 scouring rates, it's the recovery they get from wool grease keeps them in business.

9 As to the market itself, I think that it's very difficult to quantify the exact  
10 amount that it would swing in, but I think that greasy wool in China would - I don't  
11 think there'll be a big move to scour more wool in China, actually, at this stage.

12 **COMMISSIONER BEGG:** Cavalier?

13 **MR HALES:** Cavalier have got evidence that there are a number of wool scouring  
14 manufacturers in China and two of them now are producing Andar-style scours. It's  
15 our understanding that Andar sold one scour line into China in 10 years, and the new  
16 company has sold three scour lines in six months. The cost of commissioned scouring  
17 for fine wool is somewhere between 600 and 1,000 RMB per clean tonne, and the cost  
18 of scouring coarse wool or carpet wool is 950 to 1,100 RMB. So there's not a major  
19 differential between those prices, and it's not as big as what would be suggested if you  
20 were getting, say, 6 percent grease recovery and 2 percent grease recovery.

21 **COMMISSIONER BEGG:** Okay. I'll just move --

22 **MR GEORGE:** Actually, I'm not sure if this answers your question or not, but as at  
23 November last year, the best evidence we could get as that the price of scouring was  
24 between 14 and 15 US cents a kilogram. I've got to say that came through indirect  
25 channels, and I don't know if that's accurate today.

26 **MR DWYER:** It would be fair to say, too, that in China, there's no fixed scouring charge.

27 **COMMISSIONER BEGG:** One issue I'd be interested in comments on, and some of this  
28 might be discussed in the confidential session, but Futures consultants suggested that it  
29 might be worthwhile to sacrifice the China scouring, the wool that goes to China,  
30 sacrifice that, to raise the prices for wool that's used domestically, or wool that's  
31 on-sold to other markets.

32 And they were suggesting that you could forego the 14 percent that we  
33 currently sell clean to China because you could raise your prices by so much more for

1 those other markets, New Zealand and the rest of the world. I just wondered if parties  
2 would like to comment on that. Okay, Cavalier?

3 **MR FERRIER:** Commissioners, David Ferrier. I understand the question is would we  
4 forego China business so we could elevate the tariffs with respect to all business other  
5 than that. That's a conversation we wouldn't, on our own board, have much time - a  
6 proposition we wouldn't spend much time assessing. China's a very big market and it  
7 is growing. All our emphasis is on making scours as big a part of that market as we  
8 can.

9 It's the sort of strategy, you can't do it for a year or two, well, it's a failed  
10 strategy, no, we'll go back, because it will be too late. Once that volume goes, it  
11 would be gone. Obviously, our model is all about being volume-driven.

12 So to adapt that model for that sort of strategy would be inconceivable. I don't  
13 know if there are some economic aspects to it that James might be able to point to.

14 **MR MELLISOP:** That boardroom description is, I guess, what our critical loss analysis is  
15 demonstrating as well. I did respond to Dr Layton's statement in my 27 April report,  
16 just showing that if you lost what we might call the China trade, it would not be a  
17 profitable strategy and I think that's particularly emphasised by the fact that it is  
18 growing. It would seem like an unusual strategy, I think.

19 **COMMISSIONER GALE:** But doesn't it depend on how much you can charge the captive  
20 domestic users?

21 **MR MELLISOP:** Yes, that's true. So I guess if you assumed an 80 percent price increase, for  
22 example, then you get a different response. I re-ran the model - sorry, I'm not sure if I  
23 re-ran it, but just the original model from my first report, I'm basing the discussion on  
24 those results. But I agree, if you assumed a higher price increase, you'd get a different  
25 result.

26 **MR SUNDAKOV:** But it's essentially a debate about price discrimination. I mean, if you  
27 can price-discriminate, it would be completely rational for you to do that. Why would  
28 you sacrifice Chinese business if you could still get a high price domestically? So I  
29 think the question to me, is there any barrier to price discrimination? We don't  
30 observe it now, but I can't see any barriers to price discrimination, I can't see why that  
31 wouldn't occur.

32 **COMMISSIONER BEGG:** I think that's correct. I think Brent Layton, his assumption was  
33 even if you couldn't price-discriminate, it might still be a viable strategy, but obviously

1 if you can price-discriminate, it makes it much more straightforward. So let's move on  
2 to that issue of price discrimination and how feasible that is. Is that what you wanted  
3 to answer?

4 **MR HALES:** Yes. I was just going to make the point that as a commissioned wool scourer,  
5 we have little knowledge of where the wool is going to end up as its final destination.

6 **COMMISSIONER BEGG:** It seems to me it would be easy for parties to identify  
7 themselves so that they could get a low price, so you know, you could discriminate for  
8 those who said they were sending to China, but the tricky thing is to stop the people  
9 who you would like to charge a high price from saying that they're sending their stuff  
10 to China. So I just wonder if parties have any further comments? Cavalier?

11 **MR DRAKE:** Jim Drake. The information we have on the destination is only the  
12 information that our customers have given to us. Our job is to scour the wool and put  
13 it on the ship. Now, a lot of - well, probably most wool that is exported is hubbed  
14 through either Singapore or Hong Kong. So when it gets to there, it could go  
15 anywhere and we wouldn't have any idea.

16 So firstly, if we did try and discriminate by destination, there are opportunities  
17 for the customers to arbitrage, because if they don't provide us with information, we  
18 would have absolutely no idea on what the destination is, and we would be totally  
19 reliant on them to tell us that. We would have no way of actually verifying the  
20 information they're providing to us.

21 **COMMISSIONER BEGG:** I think Wool Equities had a contrary view in their submission  
22 about discrimination.

23 **MR COWAN:** If wool is being scoured for stock, that's correct, but I think in most cases  
24 where it's being scoured for a specific customer, the wool scourer's well aware of that  
25 customer and who it's going to. They also load the container and some of the loading  
26 requirements for particular countries are different and for different customers are  
27 different. So they've got a very good idea of where it's going.

28 **COMMISSIONER BEGG:** And it wouldn't be possible to hide that because that would be  
29 inefficient, I presume?

30 **MR COWAN:** Only if you want it to go to the wrong place.

31 **MR PIKE:** Cavalier have complete knowledge of all Godfrey Hirst processing prior to it  
32 being scoured simply because we have specific scouring, or Godfrey Hirst has specific  
33 scouring requirements that have to be met. So the destination of the wool to Godfrey

1 Hirst must be disclosed by the supplier at the time the instruction is given to the scour.

2 **MR HALES:** Yes, we agree with Kevin. For our largest domestic customers, we're already  
3 on long-term contracts anyhow, but I'd like to use the example for other local  
4 customers, there would be nothing to stop them using something like Abrahams Wool  
5 Exchange, which is completely independent; a box of wool goes to the Exchange, gets  
6 moved to whoever, we wouldn't have a clue.

7 **MS PAULING:** I'd just like to make the point that that would presumably add costs, though,  
8 using an independent wool exchange. And I guess the point that we have a long term  
9 contract, but it does end, it's not going to go on forever, and I guess our concern is it's  
10 obvious which is our wool. Cavalier Wool Holdings is owned 50 percent by really our  
11 biggest competitor in New Zealand, and we would also be concerned about any  
12 opportunity to effectively load up our cost to aid the competition in the carpet market.

13 At the moment that doesn't happen, as I understand it, but I mean, our whole  
14 issue with this is we can't control what's going to happen and we have no opportunity  
15 to go anywhere else if there's no Wool Services.

16 **MR CHUNG:** I'd just like to respond to that, if I may. There's three shareholders in Cavalier  
17 Wool Holdings. It's Cavalier with 50 percent shareholding, ACC, and there is Direct  
18 Capital. Cavalier's 50 percent shareholding does not give it control at board level. We  
19 specifically exclude ourselves from control so that we would not upset the market to  
20 any degree.

21 So we don't have that control, and therefore, we have two other independent  
22 investors or shareholders who would not allow us to do anything that would  
23 undermine the carpet industry at the benefit of Cavalier.

24 So I can assure, you know, that's never the case because as I said, we don't  
25 have board control.

26 **COMMISSIONER BEGG:** Okay, I'm conscious of the time.

27 **CHAIR:** Perhaps we might just take a break. I mean, this price impact issue is one that we  
28 have struggled with and I don't want to abbreviate the discussion. I'm not sure that we  
29 need a full hour and a half for the next two sessions, but if we take a break now and  
30 come back at, say, 25 to 12, and we'll take as long as we need for this session to finish  
31 these points and then see if we can do the other two before lunch, namely Vertical  
32 Integration and Superstores. So we'll see you back here at 25 to 12.

33

1 **Adjournment from 11.16 am to 11.36 am**

2  
3 **CHAIR:** We'll resume the session that we stopped at the beginning of the last question  
4 before the break and Stephen Gale is leading off with further questions on the price  
5 impact topic.

6 **COMMISSIONER GALE:** This is the bit the non-economists will enjoy the most, this is  
7 about elasticities.

8 But practically, the issue that's raised by that technical term is what diversion  
9 would there be to China if scouring prices were raised. Economic advisors to the  
10 parties have speculated about what the elasticities might be and expressed views about  
11 the ranges. But I think everybody agrees that in the abstract, it's very difficult to know  
12 what number you'd pick for the price response.

13 So I'm wondering what the demand structure looks like in the view of the  
14 economists who are here. I wonder if I can invite NERA and Castalia to step up to the  
15 whiteboard over here and draw me a demand curve. Because it seems to me that  
16 there's a block of exports that's currently going scoured to the world. The numbers we  
17 discussed a little earlier, 14 percent of that is currently going to China in scoured form  
18 and another block of it is going to other places in Asia and then some portion of it is  
19 going Godfrey Hirst and to yarn makers and so on.

20 They'll each have different sort of resistances to price increases. We've just  
21 discussed with Sue Begg, we've just discussed the price limit that's imposed  
22 somewhere by the prospect of re-entry by Godfrey Hirst or others. I've always found  
23 that if you start with a sort of a chart or a picture of what the demand looks like and  
24 what you think would happen at various levels of price rise, it can sort of crystallise  
25 well, what must the actual parameters be that go into this calculation.

26 The calculation is, as was discussed a bit before, just to what extent would it be  
27 profitable for Cavalier to forego a bit of export volume in order to make more money  
28 out of the rest of the volume? It is the matter that's addressed by NERA's critical loss  
29 analysis, it is the stuff that Dr Layton's talked about and Castalia's also expressed a  
30 view as to what the elasticity might be. But to me, the elasticity, I can't get a grip on it  
31 unless I can actually see a picture.

32 If you think you've got a better way of explaining it, I'm prepared to entertain  
33 that at all.

1 **MR SUNDAKOV:** Before we draw anything, I wonder whether I could try to summarise  
2 what I think is the difference in approach between us and NERA, and whether that  
3 helps. Because it seems to me we've sort of taken slightly different approaches to this.  
4 I think what James has done is to look at a possible range of elasticities and then  
5 discuss what's the implication of those elasticities.

6 In other words, what would be profit-maximising behaviour given these  
7 elasticities and then kind of opining on which elasticity is more likely. We've taken a  
8 different approach. We looked at, if you like, the limit pricing by how much could the  
9 price increase before it became more viable to process in China, and then said, well,  
10 let's now plug that into the critical loss analysis and see what elasticity that gives you  
11 for that to be profitable, and does that seem plausible.

12 So what came out seems like a fairly plausible elasticity, but obviously there's  
13 a range around that, but we didn't start our analysis by trying to estimate an elasticity.  
14 So I think that's probably the fundamental difference.

15 **COMMISSIONER GALE:** Yes, so I'm sort of thinking that from the discussion we've had,  
16 there's clearly at the bottom end, if you like, a sort of tranche of stuff that's going to  
17 China that has some small or like, whatever, tolerance to a price increase that's quite  
18 different to the price increase that could possibly be sustained by the domestic users.  
19 So the problem with the elasticity measure is that it sort of assumes a continuous  
20 picture, you know, a straight line or something, it's a relatively continuous curve for  
21 the way in which scouring volumes will decline as the price goes up.

22 It seems to me it may have been easier for us to understand if we think of these  
23 different customer blocks as being a bit distinct. As a first approximation, crudely  
24 thinking, well, maybe the demand response has stepped. I mean, it's very clearly  
25 stepped in the sense that I don't think anybody is saying that the price in  
26 New Zealand - the price of scouring could increase 40 percent before people would  
27 just send the greasy wool to China. The 40 percent discussion, I think, is about what's  
28 the limit of Godfrey Hirst's endurance.

29 So the elasticity thing ducks this question about the demand actually being in  
30 very different chunks. So if you're not keen to do that, I'll approach the - all right,  
31 yeah.

32 **MR SUNDAKOV:** You can draw pictures.

33 **COMMISSIONER GALE:** Hang on, we're being offered one.



1 **MS BRANSON:** [Draws on whiteboard]. This is your demand curve. So it is, as we  
2 suggested, stepped. So down at this end you've got exporting greasy wool to be  
3 scoured - exporting greasy wool that was previously going to be scoured in  
4 New Zealand; if there's an increase in the price, you might now export that greasy for  
5 scouring in China.

6 And then at the top end, which earlier discussion suggested was actually  
7 impossible for reasons other than solely price, but for logistical and practical and  
8 quality reasons, but at the top end, you've got exporting greasy wool to China for  
9 scouring there and then re-importing back into New Zealand.

10 Then on the steps in between, you've got scouring wool, instead of scouring  
11 wool in New Zealand, exporting it to China for scouring, and then onward shipment to  
12 Europe, or USA. There might be that different countries are likely to have different  
13 price thresholds at which that becomes cost-effective.

14 As Alex has suggested, rather than working out the elasticities, we can - and  
15 it's what Brent's done in his appendix A, by taking some actual cost information from  
16 the industry, is looking at, well okay, where do these thresholds occur, what's the price  
17 at which each of these become worthwhile, and therefore, by how much would the  
18 price have to increase for scouring in New Zealand before you'd consider these other  
19 options?

20 Again, deriving the elasticities, it's quite difficult. If we can work out what are  
21 likely to be the price thresholds, we've got some data at this lower end, at least, about  
22 the percentages that are being scoured in China currently, we can - it's at least a  
23 starting point in terms of looking at those elasticities and working back to what might  
24 be the critical trigger points for the elasticities.

25 **COMMISSIONER GALE:** Yes. Thank you. That's exactly what I had in mind. Can I ask  
26 you, the top step you describe as the re-importing venture, I wondered if, from the  
27 discussion we've had, do we agree there's a lower cap to that which is the re-entry -  
28 which is the entry into scouring in New Zealand that's lower than the threefold  
29 increase that Brent Layton calculated for sending the wool away to be scoured and  
30 bringing it back.

31 Because all the - you know, the estimates seem to be that something that's  
32 substantially less than a threefold increase, someone would build a new scour instead.  
33 Does that option remain, that top one?

1 **MS BRANSON:** The discussion earlier was for - this top one is exporting greasy wool that  
2 would have been scoured in New Zealand, so exporting it now to China, scouring it  
3 there and bringing it back into New Zealand.

4 **COMMISSIONER GALE:** Yeah. Would anyone do that?

5 **MS BRANSON:** We talked about in order to get to that point, there would have to be a very  
6 high increase in the cost of scouring in New Zealand, but the discussion this morning  
7 was also that there wouldn't be a price at which - there are logistical and logical  
8 reasons why that would be prohibitive.

9 **MR SUNDAKOV:** But I think that still leaves you with two possibilities. I think, it seems to  
10 me, that it's probably fair to say that the conclusion of the discussion so far has been  
11 that there probably isn't a viable prices to which people will re-import back to  
12 New Zealand. That doesn't mean, though - well, that leaves with you two possibilities,  
13 obviously.

14 One is that there is going to be a price increase capped by new entry, by  
15 re-entry for self-processing. The other possibility is that demand is perfectly elastic  
16 and it just moves somewhere else, if the cost of re-entering the market and scouring in  
17 New Zealand for your own need actually induces you to relocate both scouring and  
18 production to China.

19 **COMMISSIONER GALE:** Yes, yeah. Thank you. Okay, so the picture actually continues  
20 to the right slightly, doesn't it, downstream, which is the wool that's already going to  
21 China in raw form, right - and I'm wondering if I can ask WSI again, Mr Dwyer, not  
22 so much in terms of the picture, but I'm thinking of that boundary between raw exports  
23 of greasy wool to China and exports of clean wool to China, and I'm wondering how  
24 fluid you regard that boundary as being and the trades that you're aware of, does the  
25 volume of greasy wool versus scoured wool vary, or is it some fixed amount?

26 **MR DWYER:** In our own business, and just looking at the - which I'm going to give you a  
27 copy of this - our greasy exports to China are so small it's hardly worth mentioning.  
28 But what has happened is that our quantity of volume of scoured wool to China has  
29 taken quite a quantum leap. And I think that, depending on your operation, the  
30 dynamics of your business, your strategies, I believe that that's going to be a  
31 compelling force for increasing sales of scoured wool to China. Branding, amongst  
32 other things, price, of course. There's a whole list of things that WSI is putting huge  
33 effort into at this very moment.

1 **COMMISSIONER GALE:** Can I ask Mr Whiteman or Mr Crone what their experience is of  
2 this boundary, the amounts that are being exported greasy and the amounts that are  
3 going out scoured. Because this is all to do with the slope of that bottom piece of the  
4 picture. How fluid is that boundary? With small price increases, will we lose quite a  
5 lot more or is it resistant, is there some step required or what?

6 **MR CRONE:** I guess the reason that we are exporting larger amounts, certainly as a  
7 company we're exporting larger amounts of scoured wool to China, is we are  
8 price-competitive. But the primary focus has been on quality. We're finding that there  
9 is a swing on certain companies we deal with to the quality of New Zealand wool and  
10 the quality of the scouring they receive.

11 So that's becoming quite an important part of it. Before it wasn't so important,  
12 but our experience is now that it is becoming more important.

13 **COMMISSIONER GALE:** Sorry, is that a way of saying that if the merged entity allowed  
14 quality to drop or prevented merchants from getting the quality they wanted, the  
15 demand could drop quite quickly?

16 **MR CRONE:** Yes, quite right. I believe so. I mean, that's what we're competing on, not just  
17 price, but we're competing on the quality of our product. That's very important from a  
18 New Zealand point of view. Peter Whiteman said before that a lot of the greasy wool  
19 goes to vertically-integrated mills and it does.

20 These people have got scours and they want to just take it right through to the  
21 top or into yarn and utilise the equipment they've got. I don't think you're really going  
22 to change that unless the labour prices, labour rates, significantly increase. And as I  
23 mentioned before, they are, and it will get to a point where it will become unviable for  
24 them.

25 **MR DWYER:** I'll just add one thing, too, that water in China is becoming a very, very big  
26 issue, as are emissions, and I think that that's going to have a huge bearing on the  
27 future of the scouring industry in China.

28 **MR CRONE:** Just the one other thing I'd add to that, is that we assume if we want to scour  
29 in China, it would be easy, we could just ring up a local scourer and say we want to  
30 scour 20, 40, 100 tonne. That's not going to happen. The scours that have been  
31 identified in China, a lot of them wouldn't be able to import wool, we wouldn't be able  
32 to send wool to them to get scoured, we'd have to send it into a free trade zone.

33 Quite frankly, none of those guys are interested in doing commission scouring.

1 We have talked about it. We've talked about making fine tops in China and they're  
2 just not interested. They're interested in doing their own work. So we are assuming a  
3 lot when we say we can scour in China.

4 **COMMISSIONER GALE:** Yes. I wonder whether I've described that wrong. The way I  
5 think of it is that the grower here abandons having it scoured here and just sells the --

6 **MR CRONE:** Greasy wool.

7 **COMMISSIONER GALE:** -- greasy wool and it's somebody else's problem as to what  
8 happens to it then. Are you saying there's still a problem with sending the greasy wool  
9 into China?

10 **MR CRONE:** No, no, there's no problem there, no. That's no problem. But what I'm saying  
11 is that gradually the Chinese company, as the price of labour increases, and we assume  
12 that our price of scouring is fairly stable, then it becomes more viable for them to  
13 provide scour that's not greasy.

14 **COMMISSIONER GALE:** One riddle we've been wrestling with is why - there were  
15 questions asked before about why is it not an all or nothing proposition, why is if  
16 China's scouring is cheaper than ours, why don't they do the whole thing, and if it's  
17 more expensive than ours, then how come they're doing some greasy wool handling?

18 So I'm wondering what is the gradation, what is it that sets the fine balance  
19 where we've got not equal quantities but something of equal quantities, roughly  
20 speaking, of greasy wool and scoured wool going to China. Normally, you'd think if  
21 you were just competing in a manufacturing sector with different costs, then either  
22 they beat you or they don't beat you. But we seem to be on this sort of seesaw.

23 **MR CRONE:** Well, I think that's always been the case and it does vary from year to year.  
24 Wool grease, of course, is one factor that Michael's mentioned that is driving a lot of  
25 the greasy sales, where it may be they would be scoured here in New Zealand.

26 **COMMISSIONER GALE:** But that doesn't seem right to me. The value of the grease is  
27 coming somewhere to some player in the chain.

28 **MR CRONE:** That's right.

29 **COMMISSIONER GALE:** So if that's extracted here, that affects the price --

30 **MR CRONE:** The value stays here.

31 **COMMISSIONER GALE:** So the dirt story made some sense and the packing story made  
32 some sense, but does the leaving the grease in the wool, does the grease fetch a higher  
33 price in China or something than --

1 **MR CRONE:** No, it doesn't.

2 **COMMISSIONER GALE:** -- collecting it here?

3 **MR CRONE:** No, it's a global market.

4 **MR WHITEMAN:** There is one thing about the exports that Michael didn't allude to. There  
5 has been growth in China, but the greasies have risen similarly to scours. The  
6 percentage of export to China of greasy wool compared to scoured wool on a clean  
7 basis has been between 23 to 26 percent for years and years. That hasn't changed  
8 much at all.

9 So there has been growth in China, so there's more scoureds going, but there's  
10 more greasy going there. It's wrong to say that the growth is purely carpet. We sell a  
11 lot of greasy wool to China that goes into the carpet sector. And that's a new  
12 phenomenon and I think that growth is equal to the scoured wool growth for the carpet  
13 sector.

14 **COMMISSIONER GALE:** I guess the question that we're wrestling with is if prices - if  
15 scouring costs in New Zealand went up, does that tip that balance quite sharply, or is  
16 there some barrier to more wool going greasy to China?

17 **MR HEATH:** I think you've actually got to understand the industry. The industry is quite  
18 diversified. There are, as Peter is saying at the end of the table, that some wool goes  
19 greasy into vertically-integrated companies. That is the equivalent to Cavalier sitting  
20 in China. There are other companies which only tuft, there are some that only spin, so  
21 you've got a diversified industry and depending on what your business looks like, if  
22 I'm just a spinner, then I want scoured wool. But if I'm Cavalier, I can buy greasy  
23 wool. So you've got to understand that the companies in China, or for that matter,  
24 anywhere in the world, some are complete ground to ceiling and some are just  
25 components.

26 **COMMISSIONER GALE:** But does the yarn maker in China like the yarn makers in  
27 New Zealand, if they had their choice, prefer to deal with a scourer nearby or rely on  
28 the merchant here promising to deliver them some clean wool from New Zealand?

29 **MR HEATH:** They will buy at the best price on the best day for the best thing, just as  
30 anybody in business will.

31 **COMMISSIONER GALE:** So it comes down to price.

32 **MR HEATH:** The most vulnerable person in this equation, your stepped equation, are the  
33 contract spinners within New Zealand. They cannot sustain any price rise at all.

1 That's the Christchurch Yarn submission, basically because their competition is in fact  
2 India or China or Portugal. So any price rise here affects their ability to compete with  
3 another spinner at the tufter in Argentina or in the US or in Europe. They will be the  
4 people who go first.

5 They are significantly big employers, and whilst they may only use 6,000  
6 tonne or thereabouts, they are still critical to this economy, and they will be the people  
7 who will go to the wall if the price rises. So the only way to keep them in business is  
8 to move the price backwards to the farmers, which is what you've identified in point  
9 141. And that, I believe, is the reason you should throw this out. Because it's about  
10 employment in New Zealand and returns to farmers, wealth for the country. Those are  
11 the critical issues.

12 **COMMISSIONER GALE:** If I understand you, I think you're saying that a relatively  
13 modest price increase, that independent spinners will kill them?

14 **MR HEATH:** Yes.

15 **COMMISSIONER GALE:** Thank you. All right. So the next - okay, at the back.

16 **MR CUNNINGHAM:** Hi, it's Tony Cunningham for Cavalier. Just a point on the wool  
17 market recently; dramatic increase in the price of wool is obviously a factor in  
18 everyone costings, so that has had to have been absorbed by the users of New Zealand  
19 wool. So I don't think the cost of scouring in isolation is really the right way to  
20 approach it.

21 **MR HEATH:** All I'd say to that is the price has been universal for everyone, so the tide goes  
22 up together, all the boats go up together.

23 **MR MELLISOP:** The conversation has got away from the really exciting stuff. Can I make a  
24 couple of comments --

25 **COMMISSIONER GALE:** Yeah, please.

26 **MR MELLISOP:** -- about the demand curve. Because I know this idea of a stepped demand  
27 curve was posited in the Draft Determination, so I've given it a bit of thought, but I  
28 suppose I'm not sure where it takes us. I think the difficulty with it is that while we  
29 might think using models we can identify the price steps, we still don't know the  
30 quantity steps. We don't know the quantity coordinates on that graph.

31 I don't think it's going to be easy to do that at all. And we also, I guess, don't  
32 really know if you can categorise people discretely. I don't know, I think that's just  
33 something to keep in mind. Also, the critical loss analysis that I've done is

1 independent of shape of the demand curve. The critical elasticity does depend on the  
2 shape of the demand curve, but the critical loss is independent. So my argument about  
3 the volume sensitivity would apply regardless.

4 Because we don't know the quantity coordinates, it also makes it very difficult  
5 to know how to measure allocated inefficiency; virtually impossible, I think.

6 I think the final point I wanted to make was that either we're still assuming that  
7 there would be a single price increase to everybody, including the China trade, or  
8 we're assuming there can be price discrimination, and I'm not actually sure we finished  
9 that discussion quite before. I had another couple of comments to make.

10 A lot of that discussion is factual and so is best to come from the business  
11 people, but one thing strikes me, if the merged entity started charging one particular  
12 group of customers 40 percent more, whether it be the Summits of the world or those  
13 who end up in Europe, that's going to make life very difficult for those customers to  
14 actually buy wool from the growers, because they will now have smaller margins.

15 The growers will not be keen to sell to them, they'll want to sell to those who  
16 are getting charged less by the scourer, i.e. those who have the Chinese option. So I  
17 think there'd be a dynamic, that if you started price discriminating in that way, if it's  
18 possible, that in fact we'd see more and more New Zealand wool actually end up in  
19 China or with the option of going to China. Therefore, it would kind of be a  
20 backfiring strategy, it seems to me, for the merged entity.

21 I just wanted to make those points.

22 **MR DWYER:** I just wanted to just correct Mr Whiteman's statement, I don't agree with it.

23 The facts are, and these figures come from beef and lamb, that in 2007/2008, of all the  
24 wool shipped to China, 36 and a half percent was scoured and 2008/2009,  
25 34.9 percent, in 2009/2010, 39.5 percent and in 2010/2011 to date, 42.45 percent. So  
26 the amount of scoured wool being shipped to China is on the increase.

27 **COMMISSIONER GALE:** That was all China?

28 **MR DWYER:** China; just China.

29 **COMMISSIONER GALE:** So the total scoured's gone up, but you say the total greasy has  
30 gone down? Not as a proportion, in bales?

31 **MR DWYER:** As a proportion, it is going down at this stage. But still, in these figures,  
32 these take us to February, the season ends officially in June.

33 **COMMISSIONER GALE:** Just coming back to the diagram before we abandon that means

1 of inquiry, we got one step on the picture which is the 14 percent, that's the amount of  
2 stuff going to China at the moment scoured in New Zealand.

3 My question to the traders is, what about the rest? What about the next step of  
4 demand that we have discussed in the Draft Determination which is sales to Southeast  
5 Asia and to India in scoured form? Should we really be bundling those together with  
6 the China market? In other words, if the price of scouring went up in New Zealand,  
7 would people who are currently selling into Southeast Asia and India say, what the  
8 hell, we may as well just sell that stuff greasy to China.

9 How sensitive is that balance between what net back you get in those  
10 intermediate markets? We understand the European markets may be at something of a  
11 premium, but I haven't got a feel for India, Southeast Asia, the other parts that sort of  
12 make up the first half of total demand.

13 **MR WHITEMAN:** That's a hard one because there's not a lot of scouring capacity in those  
14 countries other than in India. In India, there's scouring capacity, so you might be  
15 better to put India in the same basket as China. But if you're talking the other  
16 Southeast Asian countries, there's virtually no scouring capacity in those countries, so  
17 it's different matter.

18 **COMMISSIONER GALE:** In that particular case, then, a Southeast Asian country with no  
19 scouring, how much of a price increase would it require for the merchant here to say,  
20 well, I may as well sell it greasy to China because China's got the capacity for the -  
21 you know, to build the carpets.

22 **MR WHITEMAN:** I'm sorry, I've no capacity to answer that. It's nearly impossible because  
23 it will be a moving target anyway. You say one figure one day, it would change the  
24 next day. It's really difficult.

25 **MR SUNDAKOV:** Could I just comment on some of the analytics. I think there's obviously  
26 some very complicated factual questions. I think, first of all, I think it's really  
27 important to keep the price discrimination issue in mind when thinking about  
28 allocative inefficiency. Clearly, if you have perfect price discrimination possible, your  
29 allocative inefficiency is going to be lower.

30 On the other hand, if that's the case, your allocative inefficiency may be lower,  
31 but I think the issues that James has described would suggest that with significant  
32 price discrimination, dynamic inefficiencies could be significantly higher because they  
33 would have quite an impact on the industry and on the way that - there are distortions



1 that would be occurring in the industry.

2 So you've kind of got to make sure that it doesn't - you know, it's like a  
3 balloon, you're going to squeeze it one place, it's going to pop up somewhere else, so I  
4 think it's very important to keep these linked very clearly.

5 I guess coming back specifically to this curve, I do wonder - I mean, I think it's  
6 kind of how much mileage just analytically one could get out of trying to construct the  
7 sort of very localised understanding of elasticities along the demand curve. I mean, it's  
8 a truism that very much in every market elasticities will change along different  
9 locations along the demand curve.

10 Typically, we use sort of simplified forms of demand curve as a way of  
11 summarising a whole bunch of complex and often contradictory information, and it  
12 seems to me it's still kind of taking a broader picture and saying what sort of  
13 elasticities are plausible here given the kinds of price increases that may be indicated  
14 by the cost differentials; it seems to be a more productive approach.

15 **COMMISSIONER GALE:** Thank you. Any other comments in response to that broad  
16 question? Okay. So that's really the end of the discussion, or the sort of factual stuff  
17 we've been trying to pick up about the sensitivity of these markets that would lead us  
18 to form a view about what constraints there'll be on Cavalier after an acquisition.

19 And indeed, what the starting point is as well in the counterfactual. So that  
20 will settle the issue of how we assess the allocative losses, and we'll come back to the  
21 productive and dynamic efficiencies later, both on the plus and minus side. So now  
22 we'll move on to the next --

23 **MR DWYER:** Excuse me. If I could, I'd just like to correct a statement, or clarify a  
24 statement I made earlier on scouring capacity. I did mention that WSI was at  
25 maximum capacity for the last three months and that one of our plants has now got  
26 25 percent commission scouring. That does not mean that WSI would not accept  
27 further commission scouring because we have a mechanism in place that alters our  
28 business programme to enable us to take considerable extra amounts of scouring if  
29 they are available on commission.

30 **COMMISSIONER GALE:** Can you outline just roughly what you do? Is it a matter of  
31 storage or is it a matter of --

32 **MR DWYER:** It's a matter of reprogramming and deferring perhaps, because we do carry  
33 stocks. We're able to switch things around, we're very flexible in our operation, and so

1 that shipments are waiting, certain destinations can be repositioned to fulfil the  
2 demand for another destination to fill our orders. And consequently, we can  
3 accommodate quite a bit of extra and always would, if we're requested, extra  
4 commission scouring.

5 **COMMISSIONER GALE:** Thank you.

6 **CHAIR:** Can I just ask one last question on the question of price impacts. It is one that we  
7 did look at very closely, not surprisingly. But in our deliberations before we did the  
8 Draft Determination, we looked very closely at the actual price impacts that opponents  
9 to the merger suggested might be possible, and the highest number, I think I'm right in  
10 saying, was 20 percent in terms of the full submission round in response to the  
11 application.

12 Now in response to our Draft Determination, we're getting vastly different  
13 numbers produced. I just really wonder what's the reason for such a marked change.  
14 What really is the industry expectation as to the potential pricing behaviour  
15 post-merger, if we do give authorisation to this proposal?

16 Perhaps it's more for the industry participants, Godfrey Hirst and other parties  
17 to talk to. I think the maximum number was 20 percent in Dr Layton's expert opinion.

18 **MS PAULING:** I guess from my point of view the concern is we don't know where it could  
19 go. As we've said, we have a scouring contract for the next four and a bit years that  
20 we're committed to. We don't know, we don't know what point it will be enough for  
21 us to look at off-shore. But as we've said, the Chinese option is difficult because it's  
22 not going to be a matter of just saying, hey, we want to scour in China and we can get  
23 access to capacity.

24 So in terms of the pricing, for us, it's going to be a matter of looking at all the  
25 other criteria as well that come into it, as to what would be the point that we feel that  
26 CWH could go to before they would think we would either set up our own scour or go  
27 to China.

28 You know, I think that's going to be fairly dynamic and it's going to depend on  
29 all sorts of things that happen over the next few years. But I guess our concern is, as  
30 they have the ability to go to whatever figure they like because there's not really any  
31 real constraints in terms of our work, China is not a constraint, so that's our concern,  
32 we could be - you could pick a number out of the air and they could go to there.

33 **CHAIR:** Is there any other party wants to make a response or comment on that point?

1 **MR SUNDAKOV:** Perhaps if I could add, just my interpretation as an economist of reading  
2 though the submissions, it seems to me they're not different estimates of the same  
3 thing, they're different estimates of different things.

4 In the first round of submissions, I think the emphasis was on sort of  
5 estimating, if you like, an overall market price increase, looking at the market as being  
6 an integrated entity. So the estimates looked at essentially at the export parity cost  
7 drivers, and James's analysis, which while it didn't focus on the cost, but essentially by  
8 looking at the market as a whole, was looking at exactly the same thing. So this was  
9 really trying to understand what would happen to the market.

10 I think in the second round of submissions, given that the Draft Determination  
11 didn't really address the vertical issues, the focus was very much on the cost potential,  
12 in a price discrimination world, of what would happen to domestic manufacturers. So  
13 I don't think it's a divergence in views about the same thing, it's a focus on quite  
14 different things.

15 **CHAIR:** Mr Dwyer?

16 **MR DWYER:** If this were to go ahead and we had a monopoly, I think WSI's trading  
17 division would be very fearful for a number of reasons relying on a monopoly, and  
18 amongst those reasons, it would not necessarily be price, but there are things such as  
19 quality, programming of shipping, space, and a whole host of other factors that I'd  
20 prefer not mention, which would give us great concern for the future of our business.

21 **MR HALES:** Mr Chairman, I'd just like some clarity on the understanding from Wool  
22 Services on the differential between commission scouring and selling scoured wool to  
23 a customer, namely Godfrey Hirst.

24 **MR DWYER:** Excuse me, but I would have thought that was patently obvious. Commission  
25 scouring is scouring with someone on commission, full stop. Selling is, in our  
26 interpretation, processing the product that we sell, and deliver, because we guarantee  
27 it.

28 **CHAIR:** Look, it may be appropriate to move now from the cost issues.

29 **MR CRONE:** Mr Chairman, I'd just like to go back to the previous rationalisation that took  
30 place in the scouring industry. Our company were fully supportive of that. But what  
31 we didn't figure on was that out of that, a monopoly situation occurred. That was in  
32 the wool dumping sector. Not long after that, rationalisation took place. The price of  
33 wool dumping, through a lot of factors, admittedly, increased variously between 10

1 and 25 percent.

2 **COMMISSIONER GALE:** So what was the response to that? Is there still a monopoly in  
3 dumping?

4 **MR CRONE:** Yes, there is. Yeah. We have no choice.

5 **COMMISSIONER GALE:** Is that because it's difficult thing to have a satellite function --

6 **MR CRONE:** The cost of entry again, but the reason for the price increases was explained to  
7 us, there were a lot of factors in there that weren't taken into account. The reality is  
8 that the person who bought the business bought a loss-making venture and then loaded  
9 it up to ensure that it was profitable.

10 **MR REID:** If it's helpful, there's a letter that we have from the Wool Exporters Council of 14  
11 August 2009 that sets out all the figures and raises the concern about the wool  
12 dumping situation, so that can be tabled.

13  
14 **POTENTIAL IMPACTS FROM VERTICAL INTEGRATION**

15  
16 **CHAIR:** I'm mindful of the time limits, and if there are further submissions, people can make  
17 those in writing. I would like to turn, if we can, to the vertical integration issue.

18 Just leading into this, there in our Draft Determination, we've identified as  
19 relevant markets the North/South Island wool scouring markets as well as the national  
20 grease market.

21 Godfrey Hirst, in particular, has run again their submission about the vertical  
22 integration concerns they have.

23 Can I begin with a question to Cavalier. I take it from your response of issues  
24 on Monday that you don't believe as a matter of law that there are more relevant  
25 markets than those we have identified in our decision? I just wonder what the basis of  
26 that submission is, if I'm reading your comments correctly.

27 **MR BLACKTOP:** Certainly, Mr Chair. We believe, Cavalier believes, that the Draft  
28 Determination has identified all the relevant markets here which are the scouring  
29 markets primarily and any other markets down there. The test in Section 67(3)(b) of  
30 the Act requires the Commission to balance the detriments resulting from the  
31 substantial lessening of competition and the courts have routinely endorsed that  
32 approach as correct.

33 And so as a matter of law, we don't think the ambit should be opened up into

1 some wide, never-ending iteration of trying to find detriments wherever they might  
2 arise. The question is very much the lessening of competition that arises from the  
3 detriments in those relevant markets.

4 The carpet market, if there are downstream vertical integration effects, the  
5 Commission has found previously that that market is competitive previously and  
6 there's no reason to believe on the facts of this case that that situation will change.

7 **CHAIR:** Perhaps Mr David would like to respond to that.

8 **MR DAVID:** Yes, Mr Chair. That iteration is as novel as it is naive. It's a  
9 clearly-established principle that if there is a monopoly or a lessening of competition  
10 at a particular market level, and that lessening of competition can potentially be  
11 leveraged into an upstream or downstream market, that's relevant for the Commission's  
12 consideration.

13 And most recently that was the approach taken by the Commission in relation  
14 to Qantas Air New Zealand, where the Commission said, "Where an acquisition  
15 involves vertical integration, the Commission will consider not simply the ability to  
16 foreclose the market, but also access concerns that it may create. A  
17 vertically-integrated firm which has market power in an upstream market has the  
18 ability to discriminate and favour its own affiliated activities in a downstream market".

19 That's exactly the point in this instance, where there is the ability of Cavalier to  
20 discriminate in favour of its downstream activities, it's own carpet manufacturing  
21 activity, vis-à-vis Godfrey Hirst and vis-à-vis other users of scoured wool.

22 **MR BLACKTOP:** If I could just respond to that. I think, fundamentally, that is consistent  
23 with what we're saying in the sense that the question is, is there a substantial lessening  
24 of competition in the carpet market for which detriments fall to be assessed. And that  
25 is the test that is applied in the Act.

26 **CHAIR:** Presumably, if there's a detriment in the upstream scouring market where horizontal  
27 market power achieves, vertical integration theory tells us we should take into account  
28 detriments in downstream markets, which I would have thought is limited to markets  
29 where Cavalier only has a presence. So we're not starting to explore a multitude of  
30 markets, but only those in which Cavalier itself is competing against other competitors  
31 in downstream markets who are dependent on it for scouring.

32 **MR DAVID:** I'd add to that, Mr Chair, we're also hearing from over here that there's a  
33 concern about upstream markets, that the effect of the lessening of competition at a

1           scouring level is going to have a direct impact on wool producers as well in terms of  
2           limiting their options for accessing scouring.

3   **CHAIR:** Okay. If we can just move on. Much of our thinking has been directed into the  
4           contractual matters and I don't think I can particularly go there, or we'll do that this  
5           afternoon in the confidential session. There are some issues that I do want to explore  
6           in relation to the contract that Godfrey Hirst has. I assume I'm right in saying we don't  
7           want to do this in this session now?

8   **MS PAULING:** We're happy to discuss elements of it.

9   **CHAIR:** I was going to get down to the actual provisions of the contract and the details and  
10          the interpretation of the contract.

11   **MS PAULING:** In terms of the term of it?

12   **CHAIR:** Yeah.

13   **MS PAULING:** Or in terms. That's --

14   **CHAIR:** Perhaps we can just do that this afternoon. I can ask some high-level questions at  
15          least to lead into an open discussion at the moment.

16   **MR DAVID:** We can certainly deal with high-level questions.

17   **CHAIR:** Yeah. Can I just explore what we think about in terms of long-term contracts in the  
18          merger situation. Because if we're faced in a situation where we think there's a vertical  
19          integration concern, and yet the party who was potentially subject to the harm has the  
20          protection of a long-term contract, what's the relevant time dimension for antitrust  
21          purposes of any such market?

22                You know, typically we're looking at three years is as far out as we go, but in  
23          the trade practice arena, we look at long-term contracts differently. I'm just struggling  
24          to think of any case where is this kind of very issue has come up, where you might  
25          have potentially a long-term contract in the merger context. I mean, just  
26          hypothetically, let's say somebody's got a court for 10 or 15 years and has the  
27          protection of performance of that contract for that period; are you arguing that we  
28          would need to be having a market that would explore the effects in year 16 or year 11,  
29          in that scenario?

30   **MR DAVID:** My response to that, Mr Chairman, would be we are looking here at an  
31          acquisition that will affect a major structural change to the industry. There will be no  
32          other scouring capacity within New Zealand. So the effect of a long-term contract can  
33          only be looked at to the extent at which it will potentially mitigate that long-term,

1 indeed potentially permanent, consequence.

2 And even there, we would say that the long-term contract itself is not sufficient  
3 protection, because what are our remedies in the event that the contract's not fulfilled?  
4 We have no other party to turn to. At the moment, we have the option of sourcing  
5 wool that's been scoured through WSI. If that's taken away, there is no fall-back in  
6 terms of the contract.

7 **CHAIR:** Would you like to make any comments on that, Mr Stock?

8 **MR STOCK:** Yes. The additional element which comes into it is always what if there is a  
9 failure to perform to the terms of that long-term contract and one party wants to  
10 exercise a right of termination for breach, when they've got no alternative to go to?

11 They're in no man's land, and therefore, the long-term context of the contract  
12 must be taken into account as well as the potential for breach of that contract and a  
13 wish to terminate early.

14 **CHAIR:** If I can just turn to Mr Taylor or Mr Blacktop there. I mean, is there any argument  
15 that we should adopt the norm of just looking for a three-year period and reach a view  
16 whether or not the contract satisfactorily covers the situation over that period of time?  
17 Or are we compelled, as others are suggesting, we have to take a long-term dimension  
18 recognising the fragility of long-term contracts?

19 **MR TAYLOR:** I think the basis for assessing it over a period of three, five years, has always  
20 been that beyond that period, it's not reasonably foreseeable what will happen. In this  
21 case, you would anticipate that over a long-term period, Godfrey Hirst would consider  
22 its position and would reach conclusions as to what it would do in the event that the  
23 contract expired and would take steps to anticipate that, and that would include new  
24 entry or encouraging new entry.

25 I think in terms of what Mr Stock has said, I think the issue is simply this: this  
26 whole rationale is about creating additional volume to gain efficiencies and the last  
27 thing that Cavalier would ever want to achieve is a major customer taking its volumes  
28 away and considering either going off-shore or losing volumes to new entry.

29 So that if you take that into account, I think all you can do is cover off the  
30 reasonably foreseeable period and assume that there are options available which will  
31 cope with the issue further down the track. So I think you just take your medium-term  
32 approach as has been the norm and pursue the analysis on that basis.

33 **MR DAVID:** I would disagree with that, Mr Chairman. This is not a clearance application,

1 this is an authorisation application. This proceeds on the basis that a statutory  
2 prohibition will in fact be invoked by the transaction that's being sought to be  
3 implemented by Cavalier. And what they're doing is coming to you and saying,  
4 notwithstanding that, there must be sufficient public benefit that it should be allowed,  
5 not just a balancing, sufficient public benefit. The benefit should be such that it should  
6 be allowed. So that you must, in deciding whether or not that benefit is there, be able  
7 to look at the competition consequences at this moment and into the foreseeable  
8 future.

9 You must have a high degree of certainty that the protection that whatever  
10 contract is in place for Godfrey Hirst or any other party is such that there will be  
11 sufficient protection there now and for the permanent structural change they're  
12 contemplating.

13 **MR REID:** Can I just say on behalf of my client that Godfrey Hirst and their contract  
14 represent only a small portion of the overall market, of course, and no doubt there are  
15 other companies that also have contracts. But some of the industry doesn't have any at  
16 all so they'll be completely at the mercy of any immediate or medium-term price  
17 increases.

18 **CHAIR:** I mentioned before that I saw the vertical integration effect to play through to all  
19 markets where Cavalier is a competitor downstream, in the downstream market sense.

20 Perhaps I can move now to what I think is the nub of Godfrey Hirst's vertical  
21 integration concern, and it's these non-price vertical discrimination opportunities. As I  
22 read the submissions, there are two predominant themes. One, that Cavalier could  
23 place the wool online, raising rivals' costs through need to hold greater inventories.  
24 And related to that is that Cavalier may not produce the wool blends desired by  
25 Godfrey Hirst.

26 Then the other characterisation of concern seems to me that Cavalier is getting  
27 access to information about its downstream rival in terms of customer base, product  
28 specification and so on.

29 Can I just start with that second main theme first, because I'm struggling to see  
30 what the difference is between the factual and counterfactual given that there already  
31 is this scouring happening under contract at Cavalier for Godfrey Hirst and so I just  
32 can't quite understand why, in this factual, suddenly this problem about access to  
33 information and learning customer bases and product differentiation arises not today



1 but tomorrow, if we allow this merger to happen.

2 So if I can just invite Godfrey Hirst to elaborate on that point?

3 **MS PAULING:** Currently, we scour a high percentage of all of our wool requirements with  
4 Cavalier, but we don't do all of it necessarily, and Wool Services have provided  
5 scouring for us because we've bought wool through them. Once Wool Services goes,  
6 all of our wool production records will be accessible by Cavalier.

7 Currently, back probably three or four years ago, Statistics New Zealand used  
8 to gather information on the production of New Zealand carpet manufacturers. That  
9 stopped. Since then, there is no access to that central body of information. What this  
10 will do is give Cavalier access to that as it relates to all of our wool products. It won't  
11 for synthetics, obviously, but it gives them a massive advantage over us in terms of  
12 market share information and basically the volume of wool carpets that we will be  
13 producing. That's a key for them because obviously they are predominantly in the  
14 wool market.

15 **MR PIKE:** We also have the choice at the moment to conduct our innovation and R&D  
16 through Wool Services specifically, to deny Cavalier the knowledge of what we're  
17 doing and what we're trying to achieve.

18 **CHAIR:** So that's the key difference, is that the product differentiation would take through  
19 the competitor's channel for scouring.

20 **MS PAULING:** Potentially, yeah.

21 **COMMISSIONER GALE:** Has that actually been happening? It doesn't come up in the  
22 discussion half an hour ago. A sort of research and development function that you're  
23 exclusively channelling through Wool Services?

24 **MR PIKE:** Not to a --

25 **MS PAULING:** Significant degree.

26 **MR PIKE:** -- significant degree, no.

27 **MR TAYLOR:** Mr Chairman, I just wonder, there are some aspects of the contract which  
28 cover this quite clearly and I think probably should be dealt with in the confidential  
29 session.

30 **CHAIR:** Yes, I'm mindful of that.

31 **MR CHUNG:** Sorry, it's Wayne Chung here. Can I just respond to a couple of comments?  
32 First of all about market knowledge. Sure, if Godfrey Hirst did scour exclusively with  
33 us, we would know what volume of wool that they need. But the world is a big

1 market. We have certain sectors of the market that we'd love to have information on,  
2 but we can't get it.

3 It's because we don't know where Godfrey Hirst directs the carpet in the first  
4 instance. So really, knowing the total is of little relevance to us; so that's the first  
5 point.

6 The second one, we talk about product innovation. If it was Cavalier, we  
7 wouldn't do product differentiation at this scale level because why would you?  
8 Because everyone else would know what that differentiation is. You know, your wool  
9 exporters would know, WSI would know.

10 So there are ample opportunities within spinning to actually do that innovation.  
11 If it was Cavalier, what we'd do is we'd do the blending at our scour unit, just to scour  
12 wool. So we'd blend, either pre-dye or post-dye. That would achieve exactly the same  
13 blending you would do at the scour level. So really, what I'm saying, from our point  
14 of view, there are alternatives to actually keeping it strictly confidential, by actually  
15 doing it in-house.

16 **MS PAULING:** I guess just in response to that, obviously there is development that we do  
17 with yarns and we do with the carpet manufacturing, but having all of our eggs in one  
18 basket with our major competitor means any opportunity to do any innovation in the  
19 scouring industry is effectively lost to us. I mean, it's not a complex process, let's face  
20 it. You get the wool, you wash it, you dry it. It's not rocket science. But within that -  
21 sorry people - but within that there is an opportunity for some innovation and  
22 effectively what this means is, I guess there's a potential for Cavalier to get access to  
23 that and not us, or nothing is innovated at all.

24 **MR DWYER:** I would like to say that, in response to Mr Wayne Chung, that we are doing at  
25 least one project which will have major implications on the scoured product and it will  
26 not be done in the yarn stage, it will be done in the scouring stage. Therefore, product  
27 development in the scouring stage is very, very important and has to be kept very  
28 secret too.

29 **CHAIR:** If there's no further comments on that particular point, I'll revert to that first main  
30 theme that was, I think, developed primarily in the Castalia submission. That is this  
31 one about, you know, the raising of rivals' costs through Cavalier having the ability to  
32 effectively dictate the inventories to delay the provision of services which could mean  
33 that Godfrey Hirst has to hold much higher inventory.

1           Perhaps if I can just invite Cavalier to respond to that theme that is very  
2           strongly emerging in submissions.

3 **MR HALES:** Okay. We're very driven, as we've said all through this morning, by volume.  
4           There's nothing that we're going to do to upset Godfrey Hirst. We're going to process  
5           their wool in the timeframes that we're doing currently, we're contractually obliged to  
6           meet the terms of the contract and we fully expect to do that in the future.

7 **CHAIR:** What would happen if the contract was to fall over, you know? If we're taking a  
8           longer term dimension, let's just talk about absent the contract, what kind of conduct  
9           can we expect from Cavalier?

10 **MR HALES:** I would expect it to be no different than what it is today. Why would a  
11           reasonable investor --

12 **CHAIR:** It's the throughput that's absolutely crucial to your operation in terms of the  
13           economies.

14 **MR HALES:** Yes.

15 **MR GEORGE:** Can I also say as a shareholder, it's an unusual situation in that there are four  
16           non-executive shareholders. None of us have an executive in the business and we're  
17           all represented through the board. The vertical integration, as I understand it, has got  
18           to have a component of control through it. In our situation, Cavalier has no control  
19           over Cavalier Wool Holdings whatsoever. In fact, the shareholders' agreement is set  
20           up to prohibit that.

21           But even practically, the management group are Cavalier Wool Holdings  
22           employees. They have this sort of situation arising every day because they scour for a  
23           broad range of customers, and they - I'm new here, but they do seem to have very, very  
24           good systems to silo all of that information and to separate it off.

25           Even in one of the earlier board meetings we went to, there was an issue which  
26           we couldn't discuss at the board meeting because it did involve something to do with  
27           the two carpet manufacturers and so we took it separately. So the company is very  
28           aware of it, but I guess the question you posed, isn't a possibility the way the company  
29           is structured, there's only two directors and management take all of those decisions.

30 **MR DAVID:** Mr Chair, the point is, as I said before, this is a permanent structural change for  
31           the industry that's being contemplated, and perhaps Mr George's most relevant  
32           comment is, "I'm new here" and there is no certainty that he or the astute Mr Goldfinch  
33           will also be represented on the board of Cavalier going forward. Things change.

1           There is no certainty that the constraints of those other shareholders will continue to  
2           apply.

3   **MR MELLSON:** I just want to comment on, I guess it's the incentives as well, which there's  
4           been discussion about control and whether that can change, but also I think it's very  
5           important to remember that ACC and Direct Capital as shareholders of Cavalier Wool  
6           Holdings will not be interested in raising the costs of Godfrey Hirst, because by  
7           definition, that sort of behaviour will reduce the profit. That's the core economics of  
8           input foreclosure, there's a trade-off. The profit of the monopoly goes down in order  
9           to increase the profit of the related business.

10                   So ACC and Direct Capital do not have that interest. So whether the board  
11           members change or not, that's not in their interests to do.

12                   Also, I have a comment on the innovation point. Are you going to come to that  
13           later, Dr Berry?

14   **MR SUNDAKOV:** Can I respond to this point perhaps? Is this time to respond to this  
15           particular part?

16   **CHAIR:** I think innovation is going to be something we will come back to in another  
17           session, so if we can just put that to one side, and we only have to touch on it for its  
18           relevance to one of the limbs of the argument, so we will come back to the innovation.

19   **MR SUNDAKOV:** I think the matter of incentives is absolutely crucial. It seems to me the  
20           incentives are kind of - and it's certainly a standard economics approach, is that  
21           regardless of how we feel about these things, the incentive for any shareholder in a  
22           company to maximise profits. So to the extent that a vertically integrated monopolist  
23           can increase the costs of its rival without reducing its own profits, there's very strong  
24           incentive to do that.

25                   James, your point seems to be that the only way to increase the cost of the rival  
26           and to undermine the rival's business is by reducing your own profits. I don't quite see  
27           how that works. In fact, most tools for increasing the costs of the rivals are there to  
28           increase your own profits.

29   **MR MELLSON:** Okay, can I explain? There's the technique of vertical arithmetic which the  
30           Commissioners may be familiar with, which is to do with price impacts, but we can  
31           think about non-price discrimination analytically in the same way.

32                   So what happens is that, in this case, CWH is the monopoly, I don't think that's  
33           the right term, but if I can use that loosely, and then one of its shareholders, 50 percent

1 is Cavalier Bremworth. So in terms of Cavalier Bremworth's financial interest in  
2 CWH, I agree with what you're saying, there will be trade-off, we reduce the profits  
3 from CWH, but we get higher profits from Cavalier Bremworth because Godfrey Hirst  
4 is injured and customers switch over.

5 My point is that that only applies to 50 percent of the shares in CWH. The  
6 other 50 percent do not gain any profit. All they get is the loss, they share in the loss  
7 from the strategy at CWH level, and they do not share in the benefit. So there is no  
8 financial incentive on Direct Capital or ACC to muck up Godfrey Hirst.

9 **MR SUNDAKOV:** I think the presumption of what you're saying is that the only way to  
10 increase the profits of the downstream company is by reducing the profits of the  
11 upstream company.

12 **MR MELLOP:** That's correct, yes.

13 **MR SUNDAKOV:** I don't think that assumption holds. I think that there are ways of  
14 maintaining the profits of the upstream company while increasing the profits of the  
15 downstream company. For example, to the extent that the profits of the upstream  
16 company are essentially just simply volume times price, the information which you  
17 derive and then can use in the carpet manufacturing market, the ability to impose the  
18 holding costs for example, the imposition of additional risks on the carpet  
19 manufacturer that will force them to hold greater stocks but wouldn't actually induce  
20 them to process any less wool with you, there are a number of ways in which you can  
21 maintain the profits of the - obviously, you'll push the limit and you will make sure  
22 you won't go beyond the limit, but there are ways to push to the limits while  
23 maintaining the volume throughput and the pricing of the upstream company, yet  
24 helping your downstream business.

25 **MR MELLOP:** Can I respond?

26 **CHAIR:** Perhaps if you respond, and then I'll shift on to Ms Branson who can make any  
27 high-level comments she may want to share. Perhaps we can provide that opportunity  
28 as well.

29 **MR MELLOP:** My only comment is that it seems to me that by definition, if we assume  
30 away Cavalier Bremworth is a shareholder, this is just a privately-owned,  
31 non-integrated firm, then would it behave in the way that's being posited? And if it  
32 would not, it must be moving away from a profit-maximising behaviour, whether that's  
33 pricing or non-pricing behaviour, otherwise it would do it without the vertical

1 integration.

2 But the argument here seems to be that it's the vertical integration that alters  
3 the behaviour. So by definition, I think you're moving away from profit maximisation.

4 **MR SUNDAKOV:** Vertical integration gives you the opportunity to do it. Without the  
5 vertical integration, you wouldn't have that access to information and the ability to  
6 influence what happens in the other market.

7 **MR MELLOP:** I'm not sure if you want us to keep going.

8 **CHAIR:** I'll park it there for the moment.

9 **MR DWYER:** Dr Berry, product innovation, are we discussing that - have the opportunity to  
10 discuss that?

11 **CHAIR:** There will be the opportunity to go into that in the session tomorrow.

12 **MR DWYER:** Thank you.

13 **MR HEATH:** Mr Chairman, just one comment. I think the focus is clearly on Godfrey  
14 Hirst. But there is, the reality is, it is the balance of the customers that need to be of  
15 concern as well. Given that wool, like meat, like milk, is a seasonal product, there are  
16 seasonal peaks in terms of processing.

17 Cavalier propose to effectively close the peak processing capacity. That will  
18 induce the need to store wool, either certainly pre-scour to ensure that they will get  
19 maximum throughput, so they will spread the processing over the full calendar year.  
20 Now, that makes sense. Purely from an economic sense, great sense.

21 However, the holding cost of that wool, which is going to be met by these  
22 gentlemen here, or by Godfrey Hirst, to hold that wool unprocessed until it is  
23 processed, that is a real cost to the industry, and that needs to be considered. I don't  
24 believe that holding cost has been adequately considered.

25 **MR HALES:** Mr Chairman, I actually disagree with that. Our proposal is actually about  
26 increasing the capacity of scouring space so that eventuality won't happen.

27 **COMMISSIONER GALE:** I think we should carry on this discussion a little bit about the  
28 incentive and ability to sabotage Godfrey Hirst if the acquisition proceeds. Maybe one  
29 way to do it is in post-conference submissions, just to clarify where the literature  
30 stands and where the logic stands.

31 In our reading, the literature is a bit ambiguous or ambivalent about whether  
32 the incentive actually exists, whether it depends on regulation, whether it depends on  
33 margins upstream and downstream and so on. But that is in the world of theory which

1 often doesn't have dimensions to it like the fact that carpet's imported into  
2 New Zealand.

3 You know there are sort of complicating features that you won't often find in  
4 the journals. So it would be useful for us to have a sort of description from Godfrey  
5 Hirst and Alex about the specific ways in which it would make sense and be profitable  
6 for Cavalier, even assuming away the shareholding question in the long-term, how  
7 they would actually make more money out of messing around with Godfrey Hirst,  
8 when both companies are in a sort of global carpet market.

9 And, James, to explain your point more carefully about those margins at  
10 different levels and the papers that follow on from the paper that Alex quoted about  
11 incentives and ability to increase costs downstream. Thanks.

12 Sorry, before we finish that, I think we did actually come to the point that for  
13 Godfrey Hirst, that wool is going via merchants but that doesn't actually screen the  
14 product from the scourer, that it seems that in the domestic market, the scourer will  
15 know exactly where it's going, both for yarn-makers and for carpet-makers, and Alex  
16 is right, that carries over into the question of price discrimination as well.

17 **CHAIR:** I'd just like to turn very briefly to how we actually --

18 **MR TAYLOR:** Mr Chairman, just before you do, just to finalise that discussion earlier, the  
19 suggestion was made by Mr David that the structure of ownership of Cavalier could  
20 change over a period or Cavalier Wool Holdings.

21 I just wanted to make the point that for that to happen, there would need to be  
22 an acquisition or a merger which would be subject to Commission scrutiny, under the  
23 substantial lessening competition test, so that issue would fall to be reconsidered at the  
24 right time when it happened.

25 **MR DAVID:** Not necessarily, Mr Chairman, it would only be if there were a shareholder  
26 who had some sort of interest in the industry. There could be a range of other  
27 shareholders who wouldn't give rise to a competition concern, and certainly wouldn't  
28 attract Commission scrutiny.

29 **MR TAYLOR:** Sorry, it would be a contract arrangement or understanding which would  
30 lessen competition.

31 **MR DAVID:** Well, no. You could get a raft of shareholders come in who individually have  
32 no involvement in the industry, are there as passive investors and don't have the  
33 characteristics or the ability to scrutinise or control or interest that are said to arise in

1 the case of Mr George and ACC.

2 **MR STOCK:** I quite agree, you could get another party such as another Direct Capital  
3 coming in, buying all the shares in Cavalier and there'd be a total change in control  
4 without any competition law issues arising.

5 **MR DAVID:** Or you could have an investor from overseas, a Chinese investor involved in  
6 the wool scouring industry potentially come in, without necessarily attracting the  
7 Commission's scrutiny.

8 **MR TAYLOR:** Mr Chairman, both Sections 47 and 27 would apply.

9 **CHAIR:** Perhaps if we can get submissions, if we can have further written submissions on  
10 those points in the post-conference round.

11 Okay. I would like to turn just briefly, I think, to the question about how we  
12 actually assess the detriments in downstream markets. I'd just like to be corrected if  
13 I'm wrong on this, but going through the submissions, the only reference I'm seeing to  
14 an attempt to quantify or specify the detriment is on page 5 of the first Castalia  
15 submission where it said that there is a limit - there's a number in confidential  
16 brackets, but it's for productive inefficiencies in the market for carpet manufacture.

17 I just wonder if Mr Sundakov could just share with us in a bit more detail  
18 exactly the basis for his calculation, the confidence he has in it and whether it has a  
19 template for how we think about other markets where there could be vertical effects.

20 **MR SUNDAKOV:** In the confidential session?

21 **CHAIR:** Is it possible to do it in a framework way at all? The problem that we're having, to  
22 some extent, is there is this assertion of a detriment in this carpet manufacture market,  
23 but the problem for us is how do we assess the detriment. Correct me if I'm wrong,  
24 but that to me, just this box here seems to be the only thing we've got to hold onto in  
25 terms of trying to work our way through this difficult issue.

26 **MR SUNDAKOV:** Sorry, I'm just trying to think. In a non-confidential setting, I guess the  
27 only thing I can do is really sort of repeat what's in the box. What we tried to do was  
28 to - and this was just perhaps speaking on one element of what may be possible, but  
29 how do you think about all of the possible effects that all really combine into  
30 increasing the risks of the business, and these risks may come out in having to hold  
31 more stocks, or they may come out - the way you deal with them, they may vary, but it  
32 all really comes down to the risks in the business. So what we tried to do was to have  
33 an estimate of what would - from the production data, what would be a decrease in



1 production.

2 **CHAIR:** So it's all based on lost production?

3 **MR SUNDAKOV:** Right, but it is just a way of sort of summarising various estimates of  
4 risk. It's not to say that lost production would occur, you may prevent loss production  
5 by holding more stocks, but it's just an attempt to put a number on the risks by  
6 measuring it in terms of possible loss production. So we're not predicting loss  
7 production to occur.

8 **CHAIR:** Okay. Have you got any comments on that, Mr Mellsop?

9 **MR MELLSOP:** I suppose two comments, Dr Berry. One is there was also some discussion  
10 in the most recent Castalia document about dynamic efficiency downstream and how  
11 you would quantify that. So I think that's a - enough times that it's been done, so I can  
12 comment on that.

13 On the one that I think you've just been discussing, if I've got the right  
14 quantification, it's the one I did consider in a 10 March response to Alex's report where  
15 all I said is I can't comment on the risk of outages, it's not an issue I know about, but it  
16 seems to me that if there would be, then the way to quantify them is basically on the  
17 surplus as opposed to the price.

18 So in other words, there would be avoided costs as well as lost revenue. So  
19 that would reduce the figure. So that's on page 4 of my document.

20 **CHAIR:** Again, I think it would be most helpful if we can get further submissions on this  
21 point to help guide us in terms of how we might think about detriments in these  
22 markets.

23 I've just got one last question on the vertical integration. It's a legal question.  
24 Chapman Tripp argue that we should be taking into account detriments not only in  
25 local downstream markets, but also in off-shore markets such as those for Australian  
26 manufacturers of carpets. Perhaps if I can start out by inviting Cavalier to respond to  
27 that legal submission.

28 **MR TAYLOR:** I think from our perspective, it was reasonably clear, and it was stated last in  
29 New Zealand Bus in 2008, and it said that, "When considering mergers under an  
30 authorisation scheme, all benefits must be taken into account whereas only detriments  
31 in a market where competition is lessened will be relevant".

32 I think it's our submission that it is only those markets where it's considered  
33 there will be a lessening of competition that is of significance, that it falls to consider

1           detriments in those markets.

2   **CHAIR:** And it has to be a market in New Zealand?

3   **MR TAYLOR:** Yes. Yes.

4   **CHAIR:** Do you want to respond to that, Mr David?

5   **MR DAVID:** Certainly, Dr Berry. Again, I'd go back to the point that this is not a clearance  
6           application, this is an authorisation application. Cavalier are saying the merger or the  
7           acquisition that we want to make will have the effect of invoking the statutory  
8           prohibition and what we are seeking from you, Commission, is an indulgence, a  
9           ruling, that we can do this in any case because of the greater public good.

10           In assessing that good, I would submit that you need to look at not just as the  
11           situation is now and just not as the law is now, we know that the New Zealand and  
12           Australian Governments have signed an accord that says we will work as quickly as  
13           we can towards a single economic market and there will be changes to our law  
14           including, in particular, our competition law, to give effect to that.

15           I would submit that you need to consider the implications, the potential  
16           implications, of Australian manufacturers, particularly Australian manufacturers who  
17           have got a close connection with New Zealand, as Godfrey Hirst has.

18   **CHAIR:** Are there any further submissions parties want to make on that point?

19   **MR TAYLOR:** Mr Chairman, I suspect it's one of those things where it might be helpful for  
20           parties to provide you with further submissions.

21   **CHAIR:** Yes, I'm assuming we'll have written submissions on that legal interpretation point  
22           as well. Can I just see if there are questions from fellow Commissioners. We have  
23           ended up in a slight overrun of time. Can I just perhaps float this idea, that we adjourn  
24           for lunch now and start back at 1.30, just have half an hour's break for lunch. So we  
25           can make a start at 1.30 on the superstore benefits.

26           I think if there's no contrary view, if we can work to that timetable, that would  
27           be most appreciated.

28

29                                   **Lunch Adjournment from 12.56 pm to 1.33 pm**

30

31                                   **SUPERSTORE BENEFITS**

32

33   **CHAIR:** Perhaps we can make a start. Apologies for the short lunch. Thank you very much

1 for being prompt in coming back at the start of this afternoon's session.

2 I'll start out with some questions on the superstore benefits argument which is  
3 one that we are looking at closely in terms of the current decision-making process.  
4 You'll see from the Draft Decision that we have a preliminary view that there are  
5 likely to be benefits through the creation of superstores in each of the North and South  
6 Islands, and that these benefits attach to reduced costs for wool aggregation, sorting,  
7 classing, testing, sale and storage, and that there's also rationalisation of transportation  
8 costs with this concept, and elimination of double-handling.

9 Can I just test to see if there are any parties wishing to make submissions,  
10 particularly opponents, as to whether or not they challenge the general validity of  
11 those kinds of efficiency gains.

12 **MR COWAN:** Wool Equities has got some concerns from the grower perspective. Firstly,  
13 that creation of the superstore, moving of all testing from what is currently a closer  
14 proximity to the farmer to a more distant proximity to the farmer, will not help the  
15 farmer with his genetics, with the way he shears his wool, with the handling of the  
16 wool and that sort of thing. So that's the first point.

17 The second point is that this isn't the only way to do this. Wool can transit in  
18 an orderly way from the wool shed to the point of its first processing, be it a dump  
19 store or a scour, in a very orderly way and all the freight savings can be made without  
20 the creation of a superstore at each Island. That can be achieved through the existing  
21 merchant network and the use of an electronic online auction system which is in  
22 existence at the moment.

23 So we would contend that for the reduced servicing of farmers, and there's  
24 probably - from what we can gather, there's improved economic benefit from using the  
25 existing merchant network and an online auction to actually the cost of creation of a  
26 superstore, that we would oppose this and we would say that the benefits of this do not  
27 stack up.

28 **CHAIR:** Can I take any other opposing comments before I invite Cavalier to respond? Are  
29 there any other views opposing the legitimacy of the claimed benefits for the  
30 superstore concept?

31 **MR PIKE:** Godfrey Hirst submitted, or submits, that essentially the superstore is proposing  
32 simply another monopoly, but this time in another part of the wool process, or in  
33 another part of wool industry. Essentially, the superstore benefit is promoting another

1 monopoly, this time in the wool supply chain. Again, another third party, possibly  
2 institutional investors, are proposed as likely owners and for the same reason as  
3 Godfrey Hirst is fearful of price gouging by Cavalier Wool Holdings in the factual, we  
4 have a similar concern with regard to what could eventuate should a superstore  
5 concept be put in place.

6 The situation at the moment where the growers largely produce relatively small  
7 numbers of bales to be sent and then aggregated into, in the North Island's case, into  
8 Napier, is one whereby the merchants that are there provide quite an efficient service  
9 and it's not practical to expect that if there's superstore, that that service would be any  
10 different, because you can't capitalise on full truckloads, using truck and trailer units,  
11 when you're going around farms on gravel roads picking up two or three bales at a  
12 time, it's simply inefficient.

13 The wool merchants are actually quite efficient as they are at the moment.  
14 They're using property assets that are, in relative terms to a new superstore, quite  
15 cost-efficient and should a superstore involving a new building of 20 to 30,000 square  
16 metres be constructed, you're talking tens of millions of dollars again and obviously  
17 the owners are going to need to extract a return on that investment.

18 There's claim that other customers will be put off using a superstore if Wool  
19 Services were involved in it. I think there's examples within the wool industry at the  
20 moment where other exporters cooperate with Wool Services, such as the  
21 New Zealand Council of Wool Interests, the New Zealand Council of Wool Exporters.

22 There are examples of wool merchants who are part-owned by Wool Services  
23 that participate and sell wool to other merchants that are working in competition with  
24 Wool Services, and Wool Services also purchase wool off competing merchants to  
25 their business as well. That's all I had.

26 **CHAIR:** Does WSI have a view on these rationalisation potential gains?

27 **MR DWYER:** We have a view so far - sorry, Joanna?

28 **MS BRANSON:** From the perspective of the economic analysis, it was simply that if there  
29 are significant benefits in the superstore concept, why hasn't that happened already, or  
30 if it's just a matter of time and it's something that's going to happen, well, if it's  
31 beneficial, why couldn't that happen under the counterfactual just as easily as under  
32 the factual? So the difference between the counterfactual and the factual would be a  
33 net zero.

1 **MR J M TAYLOR:** Did you hear that, Dr Berry?

2 **CHAIR:** Yes. Did you hear that?

3 **COMMISSIONER PICKERING:** It's not as good as it should be.

4 **CHAIR:** Perhaps it might be an idea, if you've missed that, can we just get that repeated in  
5 the microphone? Sorry to do that. I did hear, but just to make sure it is on the record.

6 **MS BRANSON:** It was simply that if there are significant benefits from the superstore  
7 concept, why hasn't that happened already, and if it's just that it's a matter of time and  
8 it hasn't happened yet, then why couldn't that happen under the counterfactual just as  
9 easily as under the factual, in which case there's no difference between the two  
10 scenarios.

11 **CHAIR:** Okay. We'll come back to that point.

12 **COMMISSIONER PICKERING:** Thank you.

13 **MR DAVID:** Mr Chairman, there's also the legal issue as to how the superstore is going to  
14 come into existence, whether in fact that itself will give rise to a business acquisition  
15 in terms of Part 2, or whether it's going to occur in the form of a series of  
16 arrangements between the operator of the superstore and individual suppliers, the  
17 aggregation of which arrangements themselves could give rise to a substantial  
18 lessening of competition.

19 So there may well be competition issues and therefore competition  
20 uncertainties about the creation of the superstore itself, so there cannot be certainty at  
21 this stage, that this concept will come to pass.

22 **CHAIR:** Okay. There's a range of emerging themes there and I think if I can just park those  
23 opposition comments for the moment and invite Cavalier at this stage to respond to  
24 those various points.

25 **MR GEORGE:** What is proposed, as you can see from the submission, is just a third party  
26 logistics operation and that's happened in many other industries and it happens where  
27 obviously the economics of integration can beat individual economics. From our  
28 analysis, that is an absolute and I guess one of the things that has arisen is since this  
29 was a public document, it's probably one of the more high-profile suggestions and  
30 structures around the superstore and it has created a great deal of discussion in the  
31 industry on it.

32 It's structured so that it does suit and advantage everyone, and you can say that  
33 with some certainty, because there is such a large cost base in the current logistics

1 channels and simplifying it and rationalising it without taking any capacity out creates  
2 quite a large saving. And just from the initial analysis that everyone's done that  
3 supports it, they seem to think there's enough to support the sheep farmers, there's  
4 enough to support the merchants, the scourers and the exporters, and I believe that to  
5 be the case, and if it isn't, if there's not enough support in any one of those areas, it  
6 would be a difficult thing to promote.

7 It doesn't need everyone involved in this. It needs a reasonable amount of  
8 volume committed to it, and we've estimated about 62 percent could make a very large  
9 and successful superstore. We've analysed primarily the opportunity in the  
10 North Island and used that as a test for New Zealand, and that's what we would  
11 propose we would start with.

12 The position we've got to now is there is an investor that's prepared to commit  
13 time and capital into this. There is support from industry participants across quite a  
14 wide range. There is capital and I think, to answer one of the other questions, that's  
15 probably been one of the reasons it hasn't happened in the past.

16 And the only thing that I can see that's not in place to a sufficient degree of  
17 certainty is the deal that you need to do with people to guarantee the revenue. It's  
18 almost the same argument we had earlier in terms of volumes. This does need volume  
19 to make it work. There are a certain number of fixed costs in the logistics business  
20 that have to be spread over volume.

21 So the proposal has developed significantly since we sent this, where we've  
22 actually had specific discussions on likely volumes, we have issued a heads of terms to  
23 one party and I think it's a matter of public record that other reasonably-sized groups  
24 have filed submissions in support of this.

25 We haven't had opposition to this in any of our discussions, but the one  
26 possible exception to that is the issue raised where there are existing facilities and it  
27 may be to start this off, you need to reach accommodations for those parties to ensure  
28 that there's an orderly change to the superstore. On the initial analysis, the margins  
29 and the superstore concept look to be significantly - well, the costs in the superstore  
30 concept looks to be significantly less than the total cost of the existing, that you would  
31 be able to accommodate some of those exit costs.

32 I think it is something that will only happen, and I think it speaks volumes, that  
33 everyone knows the logistics of wool is wrong. I think that's been a long-term

1 widespread acknowledgment in the industry, that this hasn't happened. I guess it's a  
2 good question, but why hasn't it happened? And I think it's because you need to have  
3 volumes and you need contracted volumes to attract an investor into it and to attract a  
4 bank into it, and you would need both of them.

5 You would need an investor because there is an element of property acquisition  
6 or development, and you do need a banker because it probably wouldn't work without  
7 an element of debt in it.

8 It is, again, a high fixed cost issue at the outset and you're looking to recover it  
9 over a period of time. So you need people that are committed with volumes and with  
10 reasonable terms.

11 In terms of who the investors are, I think there's been, again, a wide range of  
12 groups who have said, yes, we would like to be shareholders in that. I think Cavalier  
13 Wool Holdings is looking to be the catalyst to start this off and it's certainly not wed to  
14 ownership or 100 percent ownership at all. In fact, it would welcome investment into  
15 it. As I say, there's been in-bound interest and out-bound offers in that regard.

16 I think it is something that only works - because it takes such a lot of cost out  
17 of the supply chain, if Cavalier Wool Holdings would do it, the advantages to the  
18 farmer, to the merchants, to the scourer and to the exporters would be so great that you  
19 would force the other scour operator to do it as well, and you'd then have two  
20 businesses.

21 If there's a risk of those two businesses, I think you'd just put the investor off  
22 who thought of doing it first because he wouldn't be able to - he wouldn't be able to  
23 lock in those long-term supply contracts with sufficient certainty to get his bank  
24 funding.

25 So I think that is why - there's lots of answers about why this hasn't happened  
26 in the past and most of them have capital involved in it somewhere in that exercise.

27 I guess in terms of movement since then, we have realised that it is in fact a  
28 large executive job. This was something that was being handled by the existing  
29 Cavalier Wool Holdings management group, but it is a job of sufficient size and  
30 importance to the company that we have entered into negotiations to secure a person to  
31 do this, and it's not signed yet, but it's certainly agreed orally and we are hoping to put  
32 that in place over the next week or so. We've been tied up on this primarily.

33 But that contract is conditional upon securing the merger of the scours.

1 **CHAIR:** I don't think you've responded to the point the gentleman who just put his hand up  
2 raised to start out with.

3 **MR COWAN:** I've got four questions. Has the Federation of Wool Merchants been  
4 consulted over this, and what was their input?

5 **MR GEORGE:** Do you mind if we - several of the parties that expressed interest had asked  
6 that their interest remain confidential. Is that possible in this situation?

7 **CHAIR:** Yes, it is.

8 **MR GEORGE:** Thank you.

9 **MR COWAN:** Second question, since I'm not going to get an answer to the first one. Has  
10 the differences between the South Island been assessed to the North Island? Because  
11 the situation there is markedly different. I notice you've taken the easier Island, and  
12 analysing the North Island. It's a very different picture in the South Island. Have you  
13 done that assessment, or is that yet to be done?

14 **MR GEORGE:** Yes, we've done that assessment, but we agree with you, the North Island  
15 looks easier to secure in the first instance, and our view, and I must say we are open to  
16 input on this, that it would be better to establish it in the North Island, iron out any  
17 crinks that there are, and then establish it in the South Island.

18 **MR COWAN:** With all these savings that are going to come, has the cost of the superstore  
19 been compared to the cost of the existing wool merchant plus selling wool  
20 electronically online from that merchant network?

21 **MR GEORGE:** Yes, the superstore concept, I should stress --

22 **MR COWAN:** It's the comparative I'm after.

23 **MR GEORGE:** Yes. I mean, it is just a logistics and warehouse operation. All of the  
24 services that are being provided continue to be provided, and in many instances, by the  
25 same service providers. It's just that the wool has to be transported less for those to  
26 happen, and has to be, in some instances, transported shorter distances.

27 **MR COWAN:** I'm not sure that's the case. I'd disagree with that.

28 **MR GEORGE:** Okay.

29 **MR COWAN:** What support are wool growers going to receive from the superstore? I  
30 haven't seen any benefit package as to what support that they're going to receive in  
31 relation to what support they get currently from their local wool merchant.

32 **MR GEORGE:** Yes. In several of the discussions that we're involved in, there's no change  
33 to that part of the operation, if you're talking about the service at the farm gate level.



1 I'm just trying to think, there are probably two parties that said that they wouldn't  
2 change that component at all, and there are two or three parties that had said we would  
3 like to put that into the equation as well.

4 **MR DAVID:** Mr Chairman, there's a significant legal issue here, the giving effect to the  
5 superstore concept is going to need to be done in a way that itself gives rise to  
6 competition concerns, and Mr George has candidly referred to that.

7 He's referred to requiring 62 percent of the volume, I think he said. Now, that  
8 was a confidential figure in the Draft Determination. He said there'd need to be - to  
9 have long-term contracted volumes. So what he's talking about here, as I said before,  
10 either an acquisition or else a restrictive trade practice, a series of long-term  
11 arrangements, that themselves are going to require authorisation consideration by the  
12 Commission.

13 So we have here authorisation built on authorisation and you're being asked to  
14 have regard to benefits that will flow from this concept, when you're not yet being  
15 asked to authorise it.

16 **CHAIR:** Can I come back to that. I think that just reiterates the point you've already made  
17 earlier on.

18 Mr Dwyer?

19 **MR DWYER:** I'd just like to comment on the superstore. It depends what you call them, of  
20 course. But WSI has looked at this and is continuing to study this. We're doing a  
21 feasibility on it. Initial examination of the facts, though, are not too encouraging  
22 because the cost of building is very high, at \$500 a metre, we estimate, a square metre.  
23 But nonetheless, we are considering all options in this area.

24 What we would like to do, though, before we can start to examine in more  
25 depth these possibilities which are of great benefit, we feel longer term, or could be of  
26 benefit longer term, we haven't reached a conclusion as yet, we naturally would like to  
27 get over this hurdle of why we're all here today.

28 **CHAIR:** Can I just ask, I mean, what is your - I mean, your view is that these rationalisation  
29 benefits are likely to be real. I mean, these heads here about reduced transport costs  
30 and other wool aggregation testing, storage costs, there are substantial cost savings  
31 achievable with the superstore concept.

32 **MR DWYER:** I think that WSI is looking at the concept of direct supply from the grower  
33 and moving a lot closer to the grower longer term. We need facilities that will

1 accommodate collection of their product, and in an orderly fashion.

2 Without any doubt, I think, philosophically, the company is going to move a  
3 lot closer to its already substantial shareholder base of 3,000 wool growers, but we  
4 want to activate their participation in the business and get a lot closer and serve them a  
5 lot better than we have in the past.

6 But in getting there, we have to ensure that we have a successful organisation  
7 in the first place. That's what we've been all about, up until now.

8 **CHAIR:** Can I perhaps invite the merchants to comment. There has been a suggestion that  
9 they may be likely to be supportive of a Cavalier-led wool store rather than one where  
10 they may have been sharing store facilities with a competitor. Is that a fair comment  
11 assumption? I just wonder if there's any comments that you may want to offer in  
12 terms of whether you think this happens with the merger, but not absent the merger.

13 **MR WHITEMAN:** From our point of view, anything that consolidates the wool off farm to  
14 a first point is good. There's too much fragmentation, I'm sorry, I don't agree with  
15 Keith. I think you can move it off farm to the site where it's going to be first processed  
16 either for scouring or dumping, I think is a big step forward. I don't think it's really  
17 important whether Cavalier does it or someone else does it.

18 But in answer to the original question of why hasn't it happened in the past, it  
19 hasn't happened because there was multiple processing sites around the country.  
20 Godfrey Hirst had Invercargill, there was scours in Dunedin, there were scours in  
21 Timaru and Christchurch. In the North Island, we had scours in Martin. So from a  
22 historical point of view, it was not logical to do it.

23 Now we've got this consolidation in the industry and we're here today to talk  
24 about it further. Once it moves to two sites, or if it moves to two sites in the country,  
25 one in Napier and one in Timaru, let's say, for me it's like a wart on the end of your  
26 nose, to have a superstore attached to those two sites.

27 **CHAIR:** Do you have any comments, Mr Crone, on that?

28 **MR CRONE:** I think Peter's essentially right; that's the only comment I've got.

29 **MR TAYLOR:** Mr Chairman --

30 **COMMISSIONER GALE:** Just I just ask Godfrey Hirst. In your remarks about the  
31 superstore, you said you were worried this would create another monopoly, but it  
32 seems to me, is this not just a sort of delivery option? In what would it suppress all the  
33 other providers of transport services and storage?

1 **MR PIKE:** My concern was more along the lines that if there's institutional owners who are  
2 focused more - who are more profit-driven than industry-good driven, it's not in the  
3 best interests of the wool industry. If it's, for instance, owned by wool growers  
4 themselves, it's very logical.

5 **MR DAVID:** I think the point is, Dr Gale, whether it is in the best interests of the industry is  
6 a matter for authorisation when the concept comes forward, not now.

7 **COMMISSIONER GALE:** Yes, it wasn't clear to me how the creation of the superstore  
8 could potentially suppress the supply by anybody else of transport and storage  
9 services.

10 **MR TAYLOR:** Mr Chairman, I'd like to take up that point because I think my friend, with  
11 due respect, is trying to confuse rather than otherwise. This is a situation where the  
12 volumes become available, not due to any long-term contracts as such, but because the  
13 volumes will naturally follow the site of the scour. There's no obligation for  
14 transporters or farmers to provide wool directly to the superstore, but obviously,  
15 there'll be a benefit that will flow from reducing freight costs.

16 I think to suggest that that gives rise to a substantial lessening of competition  
17 which would require consenters taking a rather large leap of faith.

18 **CHAIR:** Could you articulate your theory of where the competitor - are you thinking of a  
19 bottleneck that, you know, it's going to generate such efficiencies and have such lower  
20 charges, that getting access to it is absolutely vital and it's not big enough to  
21 accommodate all storage?

22 **MR DAVID:** I'm not being critical of the concept, I'm just querying whether in terms of  
23 getting to the concept, you are going to find yourself having to overcome a restrictive  
24 trade practice in the form of an aggregation of a series of long-term contracts, or  
25 possibly an acquisition of an existing player in the industry.

26 Both of those matters could give rise to the need for authorisation of what may  
27 well be a laudable concept. But that's a matter that the Commission will need to  
28 consider in the context of a proposal at a later date. It's not a benefit that we can  
29 assume will come to pass here.

30 **MR TAYLOR:** Nor, Mr Chair, do I think you can assume that it will give rise to a breach  
31 without evidence that it will do.

32 **CHAIR:** Can I just move on to a number of questions just dealing - sorry, I'll give one -

33 **MR KIRKE:** Just from Wool Services' perspective, we're certainly looking seriously at the

1 concept, so you can assume that there is interest from both Wool Services and Cavalier  
2 on this issue and there's no reason - we use the term 'superstore', but there might be  
3 four semi-superstores and that could well be an as equally useful outcome.

4 **CHAIR:** So what you're saying today is that if this merger doesn't proceed, we're likely to  
5 see superstore concepts emerging also at WSI separately?

6 **MR KIRKE:** Certainly, we haven't made any decisions, but we've certainly looked very  
7 closely at it.

8 **MR HEATH:** On the issue of savings of freight, the question is, who is saving the freight?  
9 If a farmer is now freighting his wool, say, from Riverton to Invercargill, he hasn't got  
10 the cost. If then he has to freight it from Riverton to Timaru or Riverton to  
11 Christchurch, sure, there's a saving to the scour or the owner of the superstore, but that  
12 cost is clearly just transferred back to the farmer.

13 There is no real saving of cost without a whole lot of little orbital stores to  
14 consolidate loads into single truck loads. So it's a little bit more complicated than just  
15 saying, we'll just build one shed in one place. There has to be a whole lot of places to  
16 consolidate to get full unit loads before you get any saving. So it's not as simple as it's  
17 presented.

18 **CHAIR:** Cavalier, would you like to respond to that?

19 **MR HALES:** Yes, I would. The cost of freight from Riverton to wherever, is the cost of  
20 freight; it's already there today, and it's going to be there tomorrow. So you know, I  
21 don't see the point, to be quite frank.

22 **MR HEATH:** The question is who's paying? That's the point.

23 **MR GEORGE:** Could I address the general cost issue? I think we're all dealing at a point  
24 along the chain of wool and we're all facing common price points at the end of it. The  
25 proposal, the superstore proposal, is designed to take some of the cost of transporting  
26 and processing that wool, and obviously just facing the same end world price that we  
27 all sell our wool on.

28 In other industries, when you've had costs taken out, you've always had to  
29 parcel it out to all of the various stakeholders to induce them into the arrangement, and  
30 I don't think that this would be any different to any of those sorts of third party  
31 logistics operations that have had to do the same.

32 I think there's reasonably widespread expectation that the gains would be  
33 shared amongst all of the stakeholders and that's how it's being proposed as well.

1 **CHAIR:** I'd just like to ask a series of questions, just to go through the mechanics of the  
2 Applicants' case for this claimed benefit. The first one is whether Cavalier currently  
3 owns or leases land for the proposed superstore sites?

4 **MR HALES:** Yes, we do.

5 **CHAIR:** Are there any RMA or other issues, that might be concerns around that? I assume  
6 not, but - there's no approval or other regulatory issues around the sites at all that we  
7 would need to be mindful of in terms of the ability to input this concept?

8 **MR HALES:** It would be no different to any other new building process. There's obviously  
9 consents that you have to go through and some planning consents, but no, we don't  
10 anticipate - we've had extensive consultation with our local councillors, the Regional  
11 Council and the owners of the land.

12 In fact, the owner of the land is the Mission Estate Trust and they would like to  
13 do some development on the site. I don't think it's confidential to say that they want to  
14 put in a small processing site to crush their grapes and create methane, which we've  
15 agreed to buy, and five cubes of hot water at 50 degrees, which we can also buy from  
16 them. So there's all sorts of synergies coming up for this land - for this proposal,  
17 sorry.

18 **CHAIR:** What's the volume of wool, the minimum quantity of wool that would make the  
19 project feasible in both North and South Islands, and is that achievable?

20 **MR HALES:** The figures - I'm sorry I'm working from memory, but I think it was 322,000  
21 bales in the North Island, were the figures that we worked on.

22 **CHAIR:** Is that achievable without WSI's volumes?

23 **MR GEORGE:** Yes, we've got models that we've made our financial assumptions on to see  
24 if you could attract capital into that. The process can be approached moduley on this  
25 site. The site can be built I think with four bays initially, and additional bays growing  
26 on.

27 We're not expecting everyone to come onboard on day one, but with the way  
28 we've proposed it, with the superstore concept only coming in to reality and if we are  
29 able to merge the scours, there's no issue about whose volume it is any more, it would  
30 all be just pulled into the superstore concept. We're assuming the WSI trading  
31 operation would continue and they would be incentivised like everyone else to use the  
32 lowest cost supply route to the process.

33 And so I think either initially or over time, the issue would secure most

1 merchants and exporters will.

2 **CHAIR:** You mentioned before there that you may have exit cost issues for other people  
3 who form part of the infrastructure. Again, you've factored that into your analysis of  
4 whether this is a feasible project.

5 **MR GEORGE:** Yes, yes. Look, there have been people that have said, "I would be very  
6 interested in this, but I do have facilities of my own, is there a way this can be  
7 integrated into the process?"

8 In some instances, that's possible, and in many instances, it isn't. And again, I  
9 think it's just up to the company that promotes or owns the superstore concept to make  
10 it worthwhile for that party to come onboard, and as I say, there appears to be enough  
11 costs saving in it for everyone to be able to accommodate some of those people.

12 **CHAIR:** Can I just turn to a point raised by NERA in their most recent submissions. They  
13 described how there could be uncertainty of the probability about this project  
14 happening and we have a sampling assessing probabilities of, say, only 25 percent.

15 My question is more legal than economic in that sense, in that it just seems to  
16 me that we have to make an assessment whether or not a benefit is likely to occur. It  
17 is either all in or all out, and I just wonder whether there are legal submissions on  
18 whether or not the 25 percent probability rate kind of equation is something that we  
19 can turn our minds to?

20 Perhaps if I just start out with Mr Mellso, perhaps I've misrepresented what  
21 he's actually saying, what the nature of that benefit is.

22 **MR MELLOP:** No, I think you've correctly characterised it. The only point I would make  
23 is that - I'm not saying it's 25 percent, I'm just saying --

24 **CHAIR:** I'm just saying if you're conservative, if there was only a 25 percent chance it  
25 happened, this is the benefit we would see.

26 **MR MELLOP:** Yes, that's correct. Yes.

27 **CHAIR:** Perhaps that answers the question. But perhaps, would you like to make  
28 submission, Mr David, or any other opponent to the claimed benefit?

29 **MR STOCK:** Mr Chair, I think that Dr Layton will want to make comment on these matters  
30 as well on Friday, if that's possible.

31 **CHAIR:** Sure.

32 **MR DAVID:** Mr Chairman, the court has ruled previously that in terms of public benefit, the  
33 test requires an examination of likely results. In this context, 'likely' refers to probable

1 outcomes rather than merely possible or speculative outcomes. Now, I would have  
2 thought that something that has a weighting of 25 percent doesn't come within a  
3 description of 'likely', as has been --

4 **CHAIR:** But again, if we think it is likely, then we would admit the totality of the claimed  
5 benefit, it's either all in or all out, in essence, the process we go through. I do  
6 understand we are hearing from Dr Layton on this issue on Friday.

7 **MR TAYLOR:** I haven't got anything I could add to that. I think the Commission's just got  
8 to do its normal analysis and quantification and then from there work out the  
9 probabilities and weight to be given, having decided that it is a benefit that flows.

10 **CHAIR:** Okay. If there are no further questions, perhaps we can finish this session and  
11 move to the next on the Potential Impacts On Quality. But again, I would invite  
12 parties to make written submissions on this question about the superstore concept. In  
13 particular, I would be interested in legal submissions in response to Mr David's  
14 suggestion that there might be uncertainty because of additional competition issues  
15 which may attach to bringing together this concept in the future.

16 **MR DAVID:** There's also the point, Mr Chairman, that the benefit might be a likely benefit,  
17 not just a benefit, and then you take into account the likely possibility of it occurring.

18 **CHAIR:** I understand, yeah.

19 Okay, if we can pass to the next session which Gowan Pickering is going to  
20 lead relating to the Y factor benefits.

## 21 22 **POTENTIAL IMPACTS OF QUALITY**

23  
24 **COMMISSIONER PICKERING:** Thank you, Chairman. Just to correct, it's not the  
25 potential impacts on quality, it's of quality.

26 In the original application, and in subsequent papers, there were considerable  
27 discussions on the question of quality improvements that were postured and they  
28 surrounded - or were around both this question of the Y factor effect and also the  
29 improvements to WSI plants and the processing that was in there.

30 The other parties, however, have made considerable expressions of concern  
31 about many of these claimed benefits. So this session has, as its objective, to  
32 understand and establish the value of these benefits.

33 They were considerable and they make a significant difference at the end of the

1 day as to how we may or may not be able to measure the public benefits. Right at the  
2 moment, as you know from reading our position in the draft, we weren't able, with the  
3 competing statements and claims, to put any weight at this stage on these quality  
4 improvements.

5 Now, I realise that this could get into quite a technical discussion if people  
6 choose to, and there may be considerable confidentiality issues, so on the technical  
7 issues, I hope we can keep it to the commercial side of things as to what are the  
8 benefits because that's what we're trying to get a very good handle on. On the  
9 confidential, I'll have to leave you to bring those out if you wish to at any stage and  
10 we'll take them off-line.

11 What I plan to do here is to ask Cavalier to present this case and what we really  
12 want here is to understand better what improvements they've made so far and how  
13 would these claimed improvements translate into benefits. I think it's generally  
14 accepted that one unit of Y factor will give you 4 cents a kilogram. If anybody doesn't  
15 agree with that, please say so now because that's sort of a basis.

16 We also would understand clearly that it's not just the Y factor, but it's all the  
17 process improvements as well that are involved in this, and so we'd like to try and  
18 understand better those factors that might be - other factors that might be taken into the  
19 benefits.

20 I think the other important factor that we'd like to understand is, are people  
21 willing to pay, would the merchants say that they're willing to pay for these claimed  
22 benefits, for the quality, does that change things in any way? I think at the end of the  
23 day also we need to understand better the question of the counterfactual, because it  
24 would appear to some of the other parties that these things could be done, although it's  
25 claimed that they couldn't because you wouldn't want to invest, but it could be done in  
26 the counterfactual, which of course nets off the public benefit.

27 So what I'm proposing is that I ask Cavalier and then I'd like next for Wool  
28 Services to put their view, then I think I'd like to have Dr Carnaby give his view then  
29 because those are the two scourers and then I'd like to hear from Godfrey Hirst and the  
30 merchant views, and other parties as to how they would accept or otherwise what's  
31 been put forward, and then of course there are rights of reply.

32 So, Cavalier, over to you.

33 **MR HALES:** Okay. Thank you, Mr Chairman, Mr Pickering.



1           The main difference between Cavalier and New Zealand Wool Services is that  
2 Cavalier Wool Scourers is a commissioned wool scourer. We don't own any wool, so  
3 we get a very diverse type of wool through our factory. As a consequence, our  
4 equipment set-up has to be able to cope with any type of wool at a moment's notice,  
5 and as a consequence, we've been working over the last 10 years to improve our  
6 technology, to improve the flows of wool through the factory.

7           What I'm talking about flows of wool is the volume of wool. We're  
8 commissioned wool scourer so we're paid for every kilogram that goes through the  
9 factory, so we're highly incentivised to improve the processing performance of the  
10 plant and to improve the run rates. So initially, we've looked very closely at the  
11 improvements designed around increasing the run rates, and we've demonstrated over  
12 the years excellent improvements in the run rates and over a 10-year period.

13           So during that time, we've been aware also, you improve your run rates, you  
14 also have to improve your scouring quality and make sure that you just simply don't  
15 turn the wool scour up and make it go fast and the quality goes to hell.

16           So with that in mind, we've added a lot of technology that's not off the shelf  
17 technology, and again, with the view of getting run rates in mind and servicing a very  
18 diverse group of wool exporters with very different needs. Just because we've got a  
19 large percentage of carpet wool in New Zealand, doesn't mean to say that all wool  
20 types are the same.

21           We don't get the benefits of hugely long runs of wool that a merchant wool  
22 scourer would get, so we have to improvise with other technology that allows us to  
23 process difficult types of wool and often short runs.

24           We have modified our scours substantially over a period of time and we've also  
25 had the opportunity to build a brand new scour in Canterbury. When we built the  
26 scour in Canterbury, we had a very supportive board that allowed us to put in  
27 modifications into that plant that had never been seen in New Zealand before.

28           The scour down there is essentially a Topmaster scour modified to scour  
29 cross-bred wools, but also to allow the ability to scour merino as well. It's actually a  
30 hybrid. I don't think there's another one anywhere around.

31           So over the period of time, we've improved our technique, we've got our run  
32 rates up as a commissioned wool scourer, and as a consequence, we've improved the  
33 quality of the product leaving our sites. We've demonstrated to the Commission that

1 despite the evidence of some experts that you can't change the base Y colour greasy,  
2 we actually have conclusively proven that we have, and we have many examples of  
3 that.

4 **COMMISSIONER PICKERING:** Who is this being proved to?

5 **MR HALES:** Sorry, we've provided the evidence to the Commission. I'm sorry, okay. I  
6 specifically refer to the graphs on the example --

7 **COMMISSIONER PICKERING:** Is this the graph on page 30 of the application?

8 **MR BLACKTOP:** Of the application, or the most recent submission on page 7 is another  
9 easy place to see it.

10 **COMMISSIONER PICKERING:** Okay, I'll take that as - that's fine.

11 **MR HALES:** Okay, thank you. So we've got a clear line where we've got tested greasy wool  
12 and tested scoured wool, and we have a measured amount of peroxide bleach. We're  
13 saying that, yes, we use peroxide bleach and we know exactly how much we do, we  
14 measure our factory by the minute in every respect. Everything that happens in that  
15 factory, we know minute-by-minute, including our peroxide usage.

16 So we know very well that we've achieved these results and can demonstrate  
17 them.

18 **COMMISSIONER PICKERING:** So moving on from that position, you made the case that  
19 you would close down Whakatu and Kaputone and shift equipment and improve other  
20 lines.

21 **MR HALES:** Yes.

22 **COMMISSIONER PICKERING:** And this is a significant part of the public benefit that  
23 was going to come. So just talk us through that.

24 **MR HALES:** Okay. Given the experience that we've got with 3-metre technology and the  
25 developments that have proved very successful to date, and with the knowledge of the  
26 equipment that our competitors have, we've made the assessment that when we move  
27 the equipment, that their equipment will need modifications and we've clearly  
28 identified the modifications that are required to get them up to the levels of quality that  
29 our plants are currently achieving. We've got capital expenditure projections for that,  
30 and we've already costed that out.

31 **COMMISSIONER PICKERING:** What is the risk in terms of the time it takes you to do all  
32 this? We've had some discussion today about things don't always go as well as they're  
33 planned.

1 **MR HALES:** Okay. Our experience comes from a long line of rationalisations. This is the  
2 seventh one I've been involved with in my time at Cavalier Wool Holdings. The most  
3 recent example is the Godfrey Hirst example which was significant rationalisation by  
4 size, very large plants, 120-odd people, a large amount of equipment. We pretty much  
5 went right through on budget, on time and on cost through that whole deal, and it's  
6 good real live example to refer to.

7 **COMMISSIONER PICKERING:** Just going back to the improvements you talked about,  
8 have you measured those in terms of revenue gain, profit gain, over a baseline?

9 **MR HALES:** Yes.

10 **COMMISSIONER PICKERING:** Have you been able to do that in any way, shape or  
11 form?

12 **MR DRAKE:** Jim Drake speaking. Our business is based on volumes, so the higher the run  
13 rate, the lower our cents per kilo cost. So that has a positive benefit to us. Our figures  
14 pre and post the Godfrey Hirst merger shows the benefit of being able to improve  
15 those run rates.

16 **COMMISSIONER PICKERING:** So James, when you did your figures, you took what to  
17 get to that point where you had - now, you don't need to tell us precisely, well, the  
18 exact numbers because that's confidential, but just take me through the process by  
19 which you developed a public gain out of this, public benefit gain.

20 **MR MELLISOP:** Okay. I'm just trying to find the section in our original report, and we did  
21 one or two further runs later on, which I think the results have been reported to you,  
22 but if I just go to the original.

23 I suppose the first issue is how one conceptualises this benefit, and related to  
24 that is the incidents of the benefit. Because we've been quantifying the other costs and  
25 benefits in the scouring market, we chose to do the same here. So just to make the  
26 point, that that doesn't mean the incidence necessarily isn't somewhere else.

27 So we chose to conceptualise the increase in quality as effectively being that a  
28 merchant would be willing to pay the 4 cents, if we take that as the figure, more for  
29 any particular unit of scouring. So a shift out of the demand curve.

30 So we didn't use 4 cents originally, we used a range, but we've plugged 4 cents  
31 in since.

32 So we just calibrated the demand curve from existing prices and variable costs,  
33 so I won't say what they are in this forum --

1 **COMMISSIONER PICKERING:** No, no.

2 **MR MELLSOP:** -- and then really just figured out how far the demand curve would shift  
3 out, because of the increased willingness to pay. We also incorporated a price effect,  
4 an assumed one.

5 Essentially, we took the Commission's own dynamic inefficiency model from  
6 previous decisions, although we would say we improved it in the sense of  
7 incorporating a price effect which you would expect when a demand curve changes.  
8 And really then just a matter of figuring out the change in the various parts of the  
9 surplus change. So is that answering your question?

10 **COMMISSIONER PICKERING:** Well, it goes far enough at this point. I just want to turn  
11 to my economist friends here and make sure that they don't have any questions on this.

12 Because to me, this gets to the heart of. Firstly, did things happen the way  
13 they're described in your statements? Does the number that comes out, you know, is  
14 that reasonable? Then we have a public benefit number that, you know, we can rely  
15 on. That's what I'm trying to get at here, just as simple as that. So could I just ask  
16 both Sue and Stephen whether there's anything you want to ask at all? You're  
17 satisfied?

18 **COMMISSIONER GALE:** Yeah, I'm happy with that. So I take it the merchants'  
19 willingness to pay because the final customer's willingness to pay goes up?

20 **MR MELLSOP:** You can conceptualise it two ways. One is that the merchant can now  
21 purchase the same wool from the grower, but sell it at a higher price because it has a  
22 higher quality, or you could conceptualise it as the merchant can now buy lower  
23 quality wool from the grower and sell it at the same price in the world market. Either  
24 way, they've now got essentially a margin of 4 cents and therefore they will be willing  
25 to pay the scour, some of that. So you could conceptualise it either way, I think.

26 **COMMISSIONER GALE:** Right. On some measure, I think we've generally assumed that  
27 the merchant element of the market is highly competitive.

28 **MR MELLSOP:** Yes.

29 **COMMISSIONER GALE:** No one has said anything to the contrary, so assume a good  
30 measure of the benefit goes back to the grower and some goes to the scourer to induce  
31 them to make the effort.

32 **MR MELLSOP:** And incidents, I mean, Brent Layton has raised the issue of incidents. I've  
33 responded that incidents are notoriously difficult to predict, but pretty well exactly

1           what you've said is what I think would be the short-term impact. There would be  
2           some distribution between the merchant, the grower and the scourer.

3 **COMMISSIONER PICKERING:** There was some suggestion in your write-up  
4           somewhere, and I can't put my finger on it, that Cavalier looked at this as a quality  
5           improvement to satisfy merchants as opposed to a gain in profit or revenue. Is that  
6           correct or not? Have I got that wrong?

7 **MR MELLOP:** Sorry, can you say that again?

8 **COMMISSIONER PICKERING:** I'll try and find it, sorry. It's just that I think this was a  
9           customer satisfaction thing and attraction of further Commission sales. But anyhow,  
10          don't - yes, sorry.

11 **MR HALES:** I think if I could answer that, please. It's our attraction and the scours' benefit  
12          is the run rate, the continuing run rate and the continuing good quality.

13 **COMMISSIONER PICKERING:** All right. Is there anything else that you would want to  
14          say about the propositions you've put forward in terms of the Y factor, the process  
15          improvements, and the way you've calculated the public benefit out of that, or is that  
16          sufficient?

17 **MR HALES:** At this point, I don't have anything else, but I would like the opportunity to  
18          respond to questions if possible, please.

19 **COMMISSIONER PICKERING:** You will have that, absolutely, assure you of that. Okay.  
20          Could I tell to Wool Services, then? I don't know who is going to answer for  
21          this. Michael.

22 **MR DWYER:** Mr Pickering, thank you. I'll ask Adrian Donnelly to commence our  
23          argument.

24 **CHAIR:** We have some new attendees at the table since we did the round of appearances at  
25          the start of today and just for the sake of the stenographer, if the new attendees - your  
26          name, sir, is?

27 **MR RANFORD:** Steve Ranford, AgResearch Limited.

28 **MR FOOKES:** Stephen Fookes, independent consultant.

29 **MR CARADUS:** Don Caradus, Kaputone Wool Scourers, WSI.

30 **DR CARNABY:** Garth Carnaby, consultant.

31 **MR DONNELLY:** Adrian Donnelly, Whakatu Wool Scourer, WSI.

32 **CHAIR:** Thank you.

33 **MR DONNELLY:** Thank you, Michael, thank you, panel.

1 My association with Wool Services is relatively new compared to some of the  
2 others, but my background was that I was the general manager at Clifton Wool Scour  
3 in Invercargill, so the history in scouring is quite considerable. In coming to the  
4 North Island to see the differences between the two islands, is quite noticeable. There  
5 are differences in wools and the nature of how they're processed, and learning some  
6 new skills, even though I've been in the industry for quite some time, and also learning  
7 about a new plant which was a 3-metre plant, and a 3-metre plant offered advantages  
8 over a 2.4-metre plant in terms of efficiency.

9 There is an efficiency factor in a 3-metre plant that outweighs a 2.4-metre  
10 plant, still coming to grips with what it is, but also the ongoing equipment required to  
11 run that plant, and each plant manager has a different view on what he perceives as  
12 quality and what he perceives as his run rate relative to how he operates his plant.

13 So there is variation in what people do and sometimes it is personal about how  
14 people run the operation. But in terms of colour, colour is relevant to the industry and  
15 it's relevant to the industry because it's a measured value, and it is a measured value in  
16 greasy wool, that exporters buy it relative to what the Y value is, or the Y minus Z.  
17 They also need to consider, in most cases, an appraisal on the wool because sometimes  
18 they believe the wool will wash better than the colour results would stipulate, which  
19 does happen.

20 But ultimately, there is a measure in place to say that if the Y value is 60, then  
21 potentially that's what it should do all the time. If you can improve it, then you can  
22 improve it several different ways, and one is bleaching and one is equipment and one  
23 can be effluent, or liquor condition, there's a number of means that can do that and,  
24 ultimately, you can improve the Y value in a lot of those cases, sometimes probably  
25 more significantly with bleach. But other pieces of equipment can do that.

26 A lot of the colour, the way wool is scoured, is visual, it has a visual impact on  
27 who do you it for and they look at the wool and appraise it and say that's very well  
28 scoured, and ultimately, in competition through the history of scours, you'll soon be  
29 told that your scouring isn't up to scratch and that doesn't necessarily need a colour  
30 measurement to do that.

31 **COMMISSIONER PICKERING:** Is this just by somebody looking at it, or later on pulls it  
32 apart, or what?

33 **MR DONNELLY:** Looking at the brightness, on how it's scoured, and that brightness factor

1 comes back to the cleanliness and how it is done. But going back to the measure, yes,  
2 the measure can be done.

3 I've done some work since this particular event has happened and I've looked at  
4 five years' history of the plant that I'm in now, not that I was involved with five years  
5 of history, but changing your average Y value for a month, you might have 100  
6 samples of different orders that you've done, so relative to how high they were in  
7 colour value before you started, is relevant to what comes out at the end.

8 For instance, a poor colour wool, which you call a 607/8, could have Y values  
9 of 56, 57, 58 and very bright colour wools could have a high Y value of 70.

10 So if you had five orders of a Y value of 70 and one of 67, then your average  
11 that's been presented to you will be quite significantly high in Y value. If it was turned  
12 the other way around and there was nine oddment lines and one good line, then your Y  
13 minus Z would be - or your Y value would be significantly lower.

14 So it's about the input to what you get out, because --

15 **COMMISSIONER PICKERING:** So over those five years, has the input changed a lot?

16 **MR DONNELLY:** Yes, it has.

17 **COMMISSIONER PICKERING:** Therefore, there's no correlation, then, of the --

18 **MR DONNELLY:** Well, the correlation, a correlation, because a scourment is made up of a  
19 whole lot of different bits of wool with different colour values, it's averaged out on a  
20 weighted average, so if you've got 20 bales of this colour and five bales of that colour,  
21 then on a weighted average it's mixed together and they should say do you this.

22 In one of the documents where there's a testing house average of the  
23 North Island Y value, that's meant to be an average of the wool that the testing house  
24 has tested, the mix between who got that wool and which scour got it, who knows,  
25 there's no measure of that. And also that Y value is not a weighted average, it's a  
26 certificate for some fleece wool and a certificate for some oddment wool that is not  
27 done by weighted average.

28 And when I say weighted average, the fleece wool, there's more fleece wool on  
29 a sheep an oddments, so one should assume that, you know, typically if it was done on  
30 a weighted average, the Y value in that recording from the testing house would be  
31 quite different.

32 **COMMISSIONER PICKERING:** Can I just ask something here now. One of the things I  
33 want to get to is that Cavalier explain in their - that they're going to make

1 improvements that will, in effect, get to public benefits if this authorisation occurred  
2 and they were to get this business.

3 So can you show a certain set of improvements that have occurred through  
4 things you've already done over the last, say, five years, and what's your response to  
5 their ability to make these improvements that they claim? Because you've read the  
6 application there.

7 **MR DONNELLY:** In terms of making changes to a plant to improve - you know, I do it  
8 daily as a plant manager. You are looking to achieve run rates relative to your  
9 cleanliness. When I started at this plant that I'm at now, I backed the flow rate off to  
10 improve the quality. There was some issues with quality, and ultimately, you know,  
11 quality affects profits, if somebody's not happy with something.

12 So as a wool scour and being in a commissioned scour and scoured for many  
13 years for commission clients, there's a perception that the scour does the best for a  
14 client, and the test is whether he's happy with his delivery or not. And if he achieves  
15 his goal, then yes, he might put some more inferior wool in it to improve it, but the  
16 inception is that if the scourer can improve it, then I'll keep making it harder until you  
17 get to a point where it doesn't work.

18 And nowhere have I seen an exporter say that, I'm going to pay you more  
19 money for this, that the perception of a wool scourer is you scour it to the best you can  
20 to achieve what we desire.

21 **COMMISSIONER PICKERING:** Just help me with this, too, about whether you have  
22 15 percent or 10 percent commission as opposed to, as I understand it, wool that WSI  
23 buy and then scour to some specification and sell, is that making any difference, what  
24 you do there?

25 **MR DONNELLY:** It makes no difference to me as scour operator because I treat them as a  
26 client, and they've always been treated as a client. If they've got a bitch about  
27 something, they'll bitch just like anybody else, and we charge them a fee just like  
28 anybody else and everything is as if they were a commission client. Apart probably  
29 from the volume of wool that's available.

30 So our quality is just as important with them, it's no different to a  
31 commissioned client and that's the way you have to treat it.

32 **COMMISSIONER PICKERING:** Do you have a complaints register at all?

33 **MR DONNELLY:** We have a complaints register and any claims are documented. There



1 hasn't been any claims significantly in the last two to three years. Prior to that, there's  
2 probably a bit more history of it. Every scourment is typically documented and  
3 commented on, on its scouring performance in the way it looks on a --

4 **COMMISSIONER PICKERING:** So that would suggest that the quality is up to scratch for  
5 merchants, I'll come to them in a minute, and that there isn't quality improvements to  
6 be had so much as more efficiency in getting that quality; is that right or not?

7 **MR DONNELLY:** I would believe --

8 **COMMISSIONER PICKERING:** It's more for them to answer as a matter of fact, I think.

9 **MR DWYER:** Yes, that's correct, and also, we've spent a great deal of money at both - and a  
10 lot of work, both at Kaputone and Whakatatu to ensure that we are producing the best  
11 product in the industry.

12 **COMMISSIONER PICKERING:** So the state of those two plants is all that you would  
13 want it to be?

14 **MR DWYER:** It's as good as you can get at the present moment.

15 **COMMISSIONER PICKERING:** Could you say that just again?

16 **MR DWYER:** It's as good as you'll get at the present moment.

17 **MR DONNELLY:** There is always room for improvement.

18 **MR DWYER:** But there's always room for improvement.

19 **COMMISSIONER PICKERING:** Okay, all right. Dr Carnaby, would you like to comment  
20 on these two views?

21 **DR CARNABY:** Yes, Chairman. I think there's three points I'd make.

22 The first one, Nigel says, and I have no doubt that this is the case, that he's  
23 made a lot of improvements and changes at Cavalier in their scours. What we don't  
24 know, of course, is whether Cavalier started behind or ahead of Wool Services. So he  
25 may well have made changes, but then, they may not be material to a public benefit.

26 The second - well, the part of this point is that if he's made improvements and  
27 he says that there's evidence in the submission, but we've got these two graphs which  
28 are drawn from separate populations and it's possible that they do show that there has  
29 been a small improvement, I thought it might be 0.8 or it might be 1 unit of Y, which  
30 has been achieved internally to Cavalier.

31 I'd also make the point, and I made it in my submission, that an improvement  
32 of 0.8 of a unit of Y achieved over 10 years is hardly stellar. You can't see it, and it's a  
33 long bow, in my view, to say what has caused it, because there are many possible

1 causes to the change in Y, in addition to the changes that Nigel has deliberately made.

2 So that's the first point. It may well have made an improvement, but it's pretty  
3 trivial and the actual cause of the improvement, well, I would not regard it as  
4 acceptable to draw a definite conclusion as to why such a miniscule improvement had  
5 occurred because there are many other factors that can cause it.

6 So the second point really is this one about that there's no evidence presented  
7 in the case for the industry benefit to say what the comparison is with the Wool  
8 Service performance, and so I just can't see how it can be claimed that Wool Services  
9 has been asleep for 10 years, and I just happen to know that at Wool Services, there's  
10 been a lot of work done on liquor cleanliness, the whole glacial project, differentiated  
11 fibre technology projects and so on, and so it's not clear to me from the submission  
12 whether Wool Services are ahead, Cavalier is ahead, there's just no evidence  
13 presented.

14 The final point I'd make is about the 4 cents and the Y change. There probably  
15 is a threshold before you could really start to draw - you know, start to do that  
16 calculation, and it might need to be 2 or 3 cents or something you can see before a  
17 merchant would pay you for it.

18 So I'll just say that although taking these broad averages and there's a steep  
19 gradient in return for colour, that doesn't necessarily mean that if you presented two  
20 lots of wool, that you couldn't see the difference between someone who would  
21 suddenly turn up and give you 4 cents for that one.

22 So I think you came to the right conclusion in your Draft Report, that there's no  
23 weight to be based on the claims.

24 **COMMISSIONER PICKERING:** Thank you, Dr Carnaby. Can I turn to rights of reply on  
25 this particular area, because this seems to me the critical matter.

26 **MR HALES:** Okay. Firstly, just a couple of observations from Adrian's presentation.

27 Yes, I totally agree with him. A commissioned wool scourer will be told  
28 straight away by his client if the product's wrong. If it's out of spec, it doesn't get  
29 shipped. But that's not the case for a merchant wool scourer. And I use Cavalier as  
30 this example. They had a big supermarket full of wool and if one particular type didn't  
31 meet the specification, they just put it down into the next one and shipped it off and  
32 that was Lichtensteins as the example.

33 My comments on Adrian saying that they've had quality issues over a period of

1 time and have had to slow the run rates down accordingly, well, this is exactly what  
2 our submission is about. Yes, we're going to add some more equipment to make sure  
3 that that plant can process properly in the future. It's exactly what we're saying.

4 **COMMISSIONER PICKERING:** Didn't you say you'd got it back up again?

5 **MR DONNELLY:** We're back up to levels, you know, from two years ago, our run rate has  
6 increased 1,000 kilograms an hour relative to where it was set to get quality where I  
7 believed, as a scour manager, we should be. And there's still enhancements that can be  
8 made to improve that again.

9 **COMMISSIONER PICKERING:** Sorry to interrupt, I just wanted to put that one, so there's  
10 some difference there.

11 **MR HALES:** And also I take his point, we understand it and it's a new term here for us, the  
12 term, 'commission dumbing down'. I understand exactly what Adrian's saying there,  
13 that if you get to a particular level, yes, the customers will put different blends  
14 together, and again, this is exactly what we're explaining the benefit is there.

15 When you're commissioned wool scourer, that's exactly what you're trying to  
16 do, you're trying to improve your product, improve your run rates so that the exporters  
17 can change their blends around, which they do on a daily basis.

18 In response to Garth, it's not Cavalier that's only benefited from the changes,  
19 it's actually all of our customers. Those scoured wool base Y figures are across all of  
20 our customer base. I'd like to point out that we're just about to hit our 2 millionth bale  
21 this year, so it's over a lot of wool.

22 **MR DWYER:** 2 million for this year?

23 **MR HALES:** No, I'm sorry, 2 million for over the 10-year period.

24 **COMMISSIONER PICKERING:** I did understand that.

25 **MR HALES:** I also just make the point that we have presented to the Commission all of our  
26 evidence, including peroxide, run rates, base Y, percentages of oddments used,  
27 everything has gone to the Commission. So there's no lack of data from our side, but I  
28 do realise that there is a lack of data coming forward in the public versions, anyhow,  
29 from Whakatu.

30 **COMMISSIONER PICKERING:** Yes. I asked that question before just to make sure that  
31 everybody understood there was some proof statements. I accept that we have  
32 received a lot of information to back up your claims.

33 **MR HALES:** Yes.

1 **COMMISSIONER PICKERING:** Okay. Garth, do you want to say anything more at all?

2 **DR CARNABY:** Just perhaps one comment about the 10-year period, you know, when  
3 everything stays the same. One of the things that's quite pertinent to populations is  
4 whether the subset of the population has changed even slightly over that 10-year  
5 period and when we're saying all things are kept the same, we're talking about wool  
6 buyers using subjective means to say, well, the percentage of oddments is the same,  
7 but when you're trying to get down to a very small measured colour difference, I don't  
8 think you could argue that the degree of control of the wool buyers assessing these  
9 things subjectively would be so robust that you could guarantee that there wasn't a  
10 long-term shift in the proportion of, say, poorer colour wools or higher colour wools  
11 going into blends. All things being the same over 10 years is a very long time.

12 **COMMISSIONER PICKERING:** In this day and age, is still the wool buyer looking at it?

13 **DR CARNABY:** Sometimes.

14 **COMMISSIONER PICKERING:** How much technical testing is done?

15 **DR CARNABY:** You'd have to ask someone else that question.

16 **MR DWYER:** Practically everything we buy, every bale we buy, is tested.

17 **COMMISSIONER PICKERING:** Okay.

18 **MR DWYER:** And likewise, every bale we supply is tested again in the scoured state.

19 **MR TAYLOR:** Just a clarification, is it intended to put some of these questions for comment  
20 to the experts, Mr Ranford and Mr Fookes?

21 **COMMISSIONER PICKERING:** Well, what I was more referring to over the questions  
22 was there was a lot of redacted - yellowed out in our case - information about the  
23 processes. I don't know yet whether we would need to ask anything more about the  
24 processes if we know what the outcome's been. If we're sufficiently satisfied with the  
25 outcomes, then I don't need to go under the covers, in that sense.

26 **MR TAYLOR:** It's just that Mr Fookes and Mr Ranford have commented on Dr Carnaby's  
27 previous submissions at length, and now he's made some further submissions. I just  
28 thought perhaps it would be appropriate for them to comment on what he's now  
29 saying.

30 **COMMISSIONER PICKERING:** I'm happy enough with that. So the experts in this case  
31 being, Mr Taylor? The experts in this case being who?

32 **MR TAYLOR:** Mr Fookes and Mr Ranford.

33 **COMMISSIONER PICKERING:** Okay, sorry. By all means, comment.

1 **MR RANFORD:** Can I make comment on some of the issues associated with the discussion  
2 around objectivity and subjectivity.

3 You probably saw in my submission that I was pretty keen to see a bit more  
4 rigour put around some of these figures, because clearly, we live in a day and age  
5 when there is objective measurement and I think Mr Dwyer has just acknowledged  
6 that everything is measured objectively nowadays.

7 We have relative economic values that we can extract around the trade, so that  
8 we can put a value on every unit of each of the quality parameters of import in the  
9 wool trade. So that we really need to focus on some of the statistical and mathematical  
10 principles that are at play here.

11 When you're looking at a trend analysis such as has been submitted by the  
12 organisation sitting around the table today, that trend analysis in today's terms can be  
13 very, very powerful. There's many, many results in those analyses.

14 If we're talking about a subjective situation, of one person looking at two bits  
15 of wool, we're past that, we've moved on.

16 So the data that's been presented, I believe, shows statistically significant  
17 differences in the increase in Y in the Hawkes Bay wool scour. The question is, what  
18 is it due to? And as we've acknowledged, in some part, this difference could be due to  
19 the selection of types, but given the rationalisation in the scouring industry over the  
20 last five years, 10 years, there's a lot more machinery available to these plants to try  
21 out combinations and permutations of many of the research outputs we've been talking  
22 about in the last 20 years. They can now easily put these into place.

23 It is my opinion that what we are seeing is not only an increase in Y due to the  
24 selection of wool types, and I guess around that issue, I'd like to see a little bit more  
25 information on slicing and dicing what oddments and fleece types the scourers are  
26 actually processing, because I think that would probably give us an answer.

27 But I think that, yes, I think that, you know, we have the ability now to try out  
28 some of these things that we have been talking about in the research outputs, and I  
29 think indeed these have been tried.

30 Now, the issue of the small increase in Y that's been discussed at 0.8 or 1, is  
31 measurable and you can measure it over the entire clip, and you can multiply it by 4  
32 cents, and you come out with a real value. I'll just leave it at that at this stage.

33 **COMMISSIONER PICKERING:** Dr Carnaby, do you want a response to that, or do we

1 leave that?

2 **DR CARNABY:** Yeah, I'll listen to Stephen as well, if you like.

3 **MR FOOKES:** I think what Dr Carnaby has said is substantially correct. His is a set of data,  
4 and I was asked to analyse a set of data presented and verify it, presented by  
5 Hawkes Bay Wool Scour. The data was a 10-year period, and 10 years I think is a  
6 very important time span when you're looking at something that is relatively small in  
7 change, and that is because Y is hugely variable.

8 Of all the measurements that are done, Y being brightness and then Y minus Z  
9 being yellowness and fibre diameter and yield and vegetable matter and other  
10 characteristics, Y is the most variable. It's variable because it's largely affected by the  
11 environment.

12 In one year, you can have a Y value of 3 units difference or even greater on the  
13 same types of wool because of environmental issues it. It may be related to the type of  
14 soil it's been on and the weather, whether it was shorn wet or dry.

15 So to absolutely categorically have a set of data that says something has  
16 happened, a 10-year period seems to be reasonable, once you combine all of those  
17 effects.

18 Now, 0.8 of a unit may not be significant, commercially, I think it is  
19 significant. My experience over the years in interacting with manufacturers is that  
20 they tend to write contracts, specify their product that they want around tighter levels  
21 than the precision of the test can achieve. And unfortunately, because of the  
22 competitive nature of the trade, they have to actually commit themselves to those  
23 limits.

24 So the price of wool movement is not absolutely - it's not a smooth curve, it  
25 jumps in steps. There are some manufacturers in various places who might stipulate a  
26 Y of 66 or 67 or something like that. Now, when the majority, or 80 percent of the  
27 wool falls below that, somehow that has to be achieved.

28 So the price differential between 66 and 67 in that case might be huge and 65  
29 and 66 might be zero if that is the colour thing.

30 So I think it's not just a simple one unit, 4 cents. The work that Matava(?) did  
31 was about 10 years ago, 10 years old. I assume the same relevance exists now, but it's  
32 probably the only piece of research that anyone could really hang a number against.

33 But as I say, I think what Garth has said is that it's not a comparison against

1 anyone else, it's a set of data that was presented that said these are changes we've  
2 made, I've verified those independently against the test house - with the test house who  
3 actually carried it out, and it demonstrated over a 10-year period about a 0.8 change in  
4 Y value.

5 **COMMISSIONER PICKERING:** Thank you, that was very interesting. Garth?

6 **DR CARNABY:** Yeah, I think that the two submissions both make the same point, that there  
7 may well have been a small advantage to Cavalier's customers and to Cavalier  
8 through, step-wise, small changes they've made over a 10-year period, but I don't see  
9 how that's relevant to what would happen if the Wool Services' scours were changed in  
10 some way because we don't have any information about whether the current situation  
11 at Cavalier is better or worse than where Wool Services is today. We have no  
12 information in front of us.

13 **MR DWYER:** Just on the colour question, I was going to demonstrate for you the various  
14 samples of scoured wool. Would you like to see them, with varying colour?

15 **COMMISSIONER GALE:** We had a couple of shots at that on a home base.

16 **MR DWYER:** Not really? Okay.

17 **COMMISSIONER PICKERING:** We've seen a lot. Thank you.

18 **MR DWYER:** But there is a suggestion, or rather, I understand an assertion that the Y factor  
19 at Whakatu Wool Scour is lower than the Y factor at Hawkes Bay Wool Scour. There  
20 is a very simple answer to that and it's called product mix.

21 Our business at Whakatu has transformed over the last five years very much  
22 orientated to the Indian market, and in the Indian market, they buy a lot of yellow  
23 wool, and therefore, that is oddment types, such as type 607/8, 114/5, Y Z of 5, the  
24 oddment one, the 607/8, can be up to Y minus Z of 8.

25 So that you can see that the Y factor obviously is going to be a lot lower, and  
26 the reason, therefore, because we're doing so much more business in India, the reason  
27 that the average Y factor at Whakatu is lower than Hawkes Bay, is because of the  
28 client base that we now have.

29 **COMMISSIONER PICKERING:** All right. Can I now ask - the parties that have already  
30 spoken can come back again and say something, but I'd like to turn to Godfrey Hirst  
31 now and get your view of - I suppose what I'm looking for here is how have these  
32 organisations performed and particularly, again, what's your impression of  
33 improvements that could be made in your interests that are laid out in the application?

1 **MR PIKE:** Firstly, just from the outset, I'd make the statement that Godfrey Hirst does not  
2 agree that there has been an achieved benefit in scoured Y through processing. We're  
3 not disputing that Cavalier have made improvements to their process which have been  
4 targeted towards run rates and we're not professing to comment on how those  
5 improvements have worked for Cavalier, because we're not familiar with their  
6 machinery and it's their business.

7 But the interesting - in the original application at page 33 and 34, Cavalier  
8 produced some charts and they used these charts to demonstrate, or to suggest, that  
9 this was evidence of an improvement in their scouring quality over a 10-year period.

10 I just wanted to make a couple of comments regarding that information before  
11 we move on to the actual claimed improvement in Y. The first chart on page 33 is the  
12 North Island greasy wool tested Y value. That is, it's the test results from NZWTA for  
13 the wool that they have tested from the period 2002-2009.

14 It is not a weighted average, it is the result of one test per lot; a lot of wool can  
15 range between half a bale to several dozen bales, but it still produces one test result.

16 The information presented doesn't include wool that was - or greasy wool  
17 tested by SGS, and it doesn't include private lots. I'm not suggesting that it's not  
18 representative information, I'm just drawing it to the Commission's attention.

19 In terms of the chart on page 34 which summarises the achieved scoured Y  
20 results at Awatoto Scour from November 2002 to December 2009, I would just like to  
21 make the - Nigel could possibly correct me if I'm wrong here. But again, it's not a  
22 weighted average, it's simply a result per scourment and a scourment can be anything  
23 from, well, in normal terms, 10 tonne up to hundreds of tonne. Each scourment will  
24 produce one result. So again, it's not a weighted average result in the chart.

25 But nevertheless, it needs some consideration, because when Godfrey Hirst  
26 operated the scours, operated our own scours, an increase in Y such as has been  
27 presented in the Awatoto information, I'm sure would have resulted in a complaint  
28 from some of our commission customers that our processing wasn't up to the standard  
29 of our competitor. But that didn't happen. So it makes us very suspicious.

30 I approached New Zealand Wool Services and they provided some scoured Y  
31 results from Whakatu and they could only provide them for the period 2005 through to  
32 2010 because that information is extracted from the data capture in the scouring  
33 process, so the information is electronically captured and prior to 2005, before the



1 installation of their 3-metre scour, they didn't have the ability to capture that  
2 information.

3 So we received the chart from 2005 to 2010 and the surprising thing to us was  
4 that the trend indicated the scoured Y result for all the wool that has gone through  
5 Whakatu over the same period has exactly the opposite trend to Cavalier's information.

6 In analysing that, it became quite clear that even for reasons of commonsense,  
7 no prudent business owner would put up with a decreasing standard of quality to that  
8 degree over such a long period.

9 When we went back to Whakatu and - or back to New Zealand Wool Services,  
10 and asked for a break-down of the wool types that they had been processing over these  
11 years which have given rise to the information which has resulted in the chart, it was  
12 clear to us that the amount of 607/8 and oddment style wools that they have processed  
13 have increased.

14 That was suggested to - or that claim was made and just this week, Cavalier  
15 have responded and said along the lines there's no evidence to support this, you know,  
16 we want firm evidence.

17 Well, I have, in the limited time that we have had available to put all this  
18 together, received some information from New Zealand Wool Services covering the  
19 wool types that they have processed, and the same month for each year for the past  
20 four years, and it categorically shows that the amount of poorer-style wools has  
21 doubled over that time, and for that reason, Godfrey Hirst remains firmly of the view  
22 that the Y benefit claimed simply doesn't exist, and the reason we are so concerned  
23 about it is that it constitutes such a large part of the benefit claimed.

24 **MR DAVID:** Mr Chairman, in addition to Mr Pike's scepticism as to the existence of the Y  
25 enhancement, there is a serious concern as to whether, if such enhancement does exist,  
26 it in fact constitutes a public benefit. In terms of the Commission's own guidelines,  
27 the benefit claimed must be shown to be dependent on the acquisition or the practise  
28 being permitted to go ahead.

29 Now, here the enhanced Y value that's been achieved in Cavalier's own plants  
30 in a competitive environment over a 10-year period, now, presumably that can't be  
31 claimed as public benefit. So all we're looking at is the extension of that technology,  
32 or that claimed technology, to the Wool Services plants.

33 But if that enhancement were real, if Wool Services didn't take the view that

1 Cavalier were simply gold-plating their own processes, but indeed, Wool Services  
2 needed to match that technology to attract or keep the custom, attract Godfrey Hirst  
3 custom, then presumably they would adopt that own technology themselves.

4 Now, it doesn't require the merger for that to happen. Cavalier could licence  
5 the technology to them, or some other party could licence the technology to them, or  
6 indeed, we could have a situation of competition by innovation where Wool Services  
7 matches that innovation by their own enhancement.

8 So the short point is, this is not a public benefit, this is an enhancement that's  
9 been developed in a competitive environment over a 10-year period, and it doesn't  
10 require the merger for it to be extended to Wool Services' scours.

11 **MR PIKE:** Could I just make one last remark. Something I neglected to say before, and  
12 simply for the purposes of clarity, in comparing the Whakatu result to the Cavalier  
13 result, and in particular, over the last two years, given that there's only two scours in  
14 the North Island, if Whakatu scour is processing a higher percentage of poorer-style  
15 wools, it follows that Awatoto is scouring a higher percentage of better quality wools  
16 and we believe that is what's giving rise to the claimed - or to the trend on the chart  
17 that Cavalier have presented.

18 **COMMISSIONER PICKERING:** Okay, thank you. Do you want to talk about that now?

19 **MR HALES:** Yes, yes I'd like to, thank you.

20 Firstly, if you go back to 2005 where you started your comparison, you may  
21 have been starting from a comparison of pure white, and now they might have doubled  
22 their amount of oddments to, you know, to one colour. So it's a little bit of a nonsense,  
23 actually.

24 What is important is the fact that we're claiming over all of our wool types  
25 oddments, dag wool, everything, that we're increasing the base Y by 0.8 to 1 unit.  
26 That's what's important. It's not the wool type. We're not fearful of any wool type that  
27 we scour because we're going to add that value to whatever we get.

28 But just to put your mind at ease, we believe that we scour as a commission  
29 wool scourer, and you'd be aware of this, Kevin, that we scour a disproportionately  
30 high percentage of bellies and pieces, and like Wool Services, we keep pretty good  
31 records as well.

32 I can tell you that our percentage of bellies and pieces and poor-style wools is  
33 way above what you would expect to skirt off a fleece as an average skirting ratio, and

1 that it hasn't changed. If anything, has gone up over the 10-year period, and we've  
2 taken those figures over the five-year period and there is a trend line, a slight trend line  
3 upwards.

4 But further to that, from the Lanolin Trading Company records, we wash 90  
5 percent of the dag wool in New Zealand. I'm happy to share that figure; 93 to be  
6 exact. So, you know, let's dispel that myth right now.

7 Also, the percentage of wool going to India, I note in - and I note from some  
8 recent reports that Wool Services state they've got 60 to 65 percent market share going  
9 to India. That indicates that our customers have got 40 percent, so we're well  
10 experienced with the Indian market as well.

11 But if you look at June 2009, meat and wool figures, 9.3 percent of  
12 New Zealand exports went to India. June 2010 sorry, sorry I'm going backwards, 9.3 -  
13 yeah.

14 Sorry, I've got my figures mixed up here, just give me a minute to sort myself  
15 out. Okay, June 2009, 9.3 percent going to India; June 2010, 8.8, and year to date,  
16 February, 7.70.

17 **COMMISSIONER PICKERING:** Which report was that?

18 **MR HALES:** The meat and wool stats.

19 **COMMISSIONER PICKERING:** Meat and wool for this period, this year, okay.

20 **MR PIKE:** Excuse me, Nigel, but you're quoting figures from this financial year?

21 **MR HALES:** Yes, I am. These figures, here they are here.

22 **MR PIKE:** What period are you quoting figures for?

23 **MR HALES:** I'm not going to show these trends because I haven't showed them to the  
24 Commission.

25 **MR PIKE:** No, that's fine.

26 **MR HALES:** We've got year ending 2003 to June --

27 **MR DWYER:** I think, sorry, can I say something, sorry.

28 I think it should be appreciated, though, that the Indian market doesn't just buy  
29 all poor-colour wools. They buy the very best of wool as well, the very best. And to  
30 listen to Nigel, I can't believe that sheep are actually growing more bellies than pieces  
31 than they ever --

32 **COMMISSIONER PICKERING:** That's exactly what I was wondering, where is it all  
33 coming from?

1 **MR HALES:** What I'm saying here is that we scour a disproportionately higher percentage  
2 than our competitors. So if there's 15 percent bellies and pieces generally taken off a  
3 fleece, we're higher than that. So that would indicate, if we're at 20 percent, they're at  
4 10.

5 **MR PIKE:** I'd say, with respect, that I completely understand that. But what's more  
6 important is the change in those styles of wool over the period covered by the charts,  
7 because if you've scoured 90 percent of one style of wool all through the period, it  
8 doesn't constitute a change in the - or it shouldn't - what we're saying is it's not going  
9 to create a substantial difference, or a trend line on your chart.

10 But what we do know is that, particularly in the last couple of years,  
11 New Zealand Wool Services have scoured a lot less good quality wool through their  
12 Whakatu plant, and as I've said, because of that, you must have scoured more of the  
13 better quality wool, and it follows that your results must have improved and  
14 New Zealand Wool Services' must have declined, but that's no indication of the quality  
15 of the scouring.

16 **MR HALES:** Well, no, that's unproven, actually. The reduction in Y, until it's substantiated,  
17 could be a reduction in bleach. It could be an increase in iron staining, it could be an  
18 increase - we've heard from Adrian that they've had quality issues --

19 **MR DONNELLY:** No, no, I didn't, but there was in previous times.

20 **MR HALES:** Referring to previous. So therefore, we have to assume that there's been some  
21 issues, and they may be re-surfacing and actually the product may be duller now than  
22 what it was before. You know, until it's proven, it's --

23 **MR PIKE:** I think commonsense and logic would suggest that no prudent business owner  
24 would put up with deteriorating quality that they can rectify through changes in their  
25 plant.

26 **COMMISSIONER PICKERING:** In terms of the conference, I don't know that this is  
27 going to help us come to our decision, going any further with this particular thing.  
28 You guys might like to sort it out yourselves. I'm not sure how hopeful I am of that.

29 One technical matter here which I'll announce, and then the Chairman can  
30 decide what we do. Because we started a little early, 1.30, of this session, the  
31 stenographer must get a break and we're within about five minutes of now, so we've  
32 got to decide how we follow from here.

33 **CHAIR:** Perhaps we might just take a break at 3.30 and come back, we'll give it 15 minutes

1 for the afternoon tea break, which then means we can come back and do the rest of the  
2 day, starting at quarter to four.

3 **COMMISSIONER PICKERING:** That all right with everybody?

4 **MR WHITEMAN:** If there's something you want to know from the exporters and traders,  
5 would that be possible to get that in five minutes now? Then we can go.

6 **COMMISSIONER PICKERING:** Yeah, we can try that.

7 **CHAIR:** With the stenographer's indulgence, we can have a try at that.

8 **COMMISSIONER PICKERING:** We can try that. Let me ask the traders and Wool  
9 Equities, what would you like to say about this arena?

10 **MR WHITEMAN:** I have nothing special to say, I just wondered if someone wanted some  
11 questions from someone who might be --

12 **COMMISSIONER PICKERING:** My main concern at the start of this was this question of,  
13 well, are you or are you willing to pay for this supposed 0.8 or whatever, or how does  
14 it play out to the merchant?

15 **MR CRONE:** No.

16 **MR DWYER:** I would say, thank you very much to the scourer. But pay, no.

17 **COMMISSIONER PICKERING:** But they're answering it, not you, Michael.

18 **MR CRONE:** The answer is no. I mean, the improvement says that the Y factor has  
19 improved by 0.8 to 1. The question really is what is the precision of the test, the actual  
20 test? I suggest that the precision of that test to the Y factor, or Y minus Z, is plus or  
21 minus 0.7. So, Garth, I don't know whether that's correct or not, but I believe it is.

22 **DR CARNABY:** Not quite, but the precision is not sufficient on a single test to make 0.8.

23 **COMMISSIONER PICKERING:** The gentleman from AgResearch, you had a comment  
24 on that before, did you, or not?

25 **MR RANFORD:** We're not talking about single measurements here, we're talking about  
26 trends with thousands of results.

27 **COMMISSIONER PICKERING:** Yes, yes.

28 **MR CRONE:** Let's just say, then, that we haven't noticed any discernible difference in our  
29 scouring.

30 **COMMISSIONER GALE:** I think the question is more going right back to the very start of  
31 the session where I thought it was agreed that 4 cents is a real number. That if the  
32 product for which the Y parameter is a measured number, has a larger value than a  
33 smaller number, that it's 4 cents per unit, are you saying that wouldn't be realised in the

1 market, when people specify what you sell overseas?

2 **MR CRONE:** Probably not.

3 **COMMISSIONER PICKERING:** Peter, do you want to say something?

4 **MR WHITEMAN:** I think there's two ways to look at that. Whether we can argue that 4  
5 cents is achievable or not, I don't think there's anyone who can strongly refute it. So to  
6 all intents and purposes, let's accept that that is something that doesn't need to be  
7 discussed. There is a value and 4's not inconceivable.

8 Where the 4 cent value falls, that's the issue. I suspect a lot of it goes back to  
9 the farmer and that we can then, once we've established that premium, pay a little  
10 more for a lesser wool to achieve the same Y value. Some of that, the scourer may  
11 well get, but you know, I think we have to be reasonable that most of that would end  
12 up back with the farmer.

13 **COMMISSIONER PICKERING:** Thanks. The gentleman back there.

14 **MR WEINSTEIN:** Hi, Steve Weinstein. I could tell you, from the marketing side where I  
15 sell my wool in the United States, that my clients are prepared to pay for a base Y of  
16 66 and pay 2 to 3 cents per pound premium for added bleach to get it towards 70. So  
17 in the marketplace, the marketplace that demands pastel colours, they do, and I have  
18 sold wool with a premium.

19 **COMMISSIONER PICKERING:** Okay, thank you. I think it's only Wool Equities who  
20 are left, you can choose to speak now or after, because we are right on 3.30 and I'm  
21 very conscious of --

22 **MR COWAN:** I think I was probably just going to reiterate, that I think the 4 cents is there, I  
23 have no doubt about that at all. I think when the exporter merchant puts his blend  
24 together, he works on getting that out of the scour, just like he works on getting a  
25 reduction of 0.1 VM out of the scouring process, and he just accepts it. Peter's  
26 probably right, it does come back to the farmer in an increased price when the wool is  
27 bought by the exporter.

28 **COMMISSIONER PICKERING:** Okay.

29 **MR DONNELLY:** Just one more thing, that has been there for a number of years and it's not  
30 new and the practice is not anything added to what's different now. Would that be  
31 fair?

32 **MR COWAN:** We used some computer software that took all of this into account when we  
33 developed the software. We haven't changed it for the last seven years, so we're just

1 accepting the same factors and seeing the same results at the end.

2 **COMMISSIONER PICKERING:** All right, thank you for that. I'll hand back to the  
3 Chairman.

4 **CHAIR:** Okay, thanks very much. We'll convene in 15 minutes.  
5

6 **Adjournment from 3.31 pm to 3.51 pm**  
7

8 **CHAIR:** Thanks very much for coming back. We'll now commence the final session for the  
9 day which will begin by the last stage on the Y benefits, then at the end of that we'll  
10 then move to the confidential session. I should add, the confidential session will be  
11 closed only to those parties who have signed the undertakings as to confidentiality. I  
12 understand the counsel assisting the Commission has discussed with the legal advisors  
13 to all the other parties and that Cavalier no longer is proposing to have its experts  
14 appearing to speak to their points.

15 **MR DUNNING:** I'm not sure that's - it's the CFO we're talking about isn't it?

16 **MR TAYLOR:** Yes, I think what I said was if the Commission - we were putting up the  
17 CFO in order that the Commission would be able to ask questions because the model  
18 is the model that he produced and the person best able to give clarification of the  
19 contents of the model would be him. But absent that, as long as the Commission is  
20 happy to accept the discussions from Mr Mellsop, because he's discussed the matters  
21 with the CFO, in that case I think we can do away with the CFO being present.

22 **CHAIR:** Fine.

23 **MR TAYLOR:** Not do away with him, just do away with him being present.

24 **CHAIR:** It may be for this confidential session his presence may not be that much at issue in  
25 terms of what we need to discuss in this closed session. But we'll walk into that when  
26 we get to the closed session.

27 **MR TAYLOR:** It struck me that that was a section on that model and costs was perhaps  
28 better left until Dr Layton was available on Friday anyway.

29 **CHAIR:** That's right. We had a brief discussion amongst ourselves and there's only, it  
30 seems, two items for the confidential session that we want to explore, one is the  
31 contract and the second point that we would just want to look at is some further  
32 material on the superstore concept. So that this will be a fairly brief session and, you  
33 know, we were anticipating that Friday morning when Dr Layton is here is when we

1 will have the opportunity to fully go over in detail all of those kind of issues.

2 **MR TAYLOR:** I'm not sure whether you wanted some confidential session on the Godfrey  
3 Hirst contract. Talking with Mr David we thought perhaps both our clients should be  
4 present for that because they probably understand it better than we do. We can make  
5 legal comments about the contract, but the clients might want to be present.

6 **MR DAVID:** Quite comfortable with that, Mr Chairman.

7 **CHAIR:** If both parties are comfortable, then we can begin.

8 **MR TAYLOR:** Unfortunately Mr Ferrier, who negotiated all of that, has had to fly back to  
9 Auckland, he'll be back again in the morning. So perhaps we can do that in  
10 tomorrow's confidential session.

11 **CHAIR:** Yeah.

12 **MR DAVID:** That would be acceptable to us.

13 **CHAIR:** Okay, let's park that until tomorrow then, yeah. Okay, the confidentiality session is  
14 going to be fairly brief then today. Okay, I'll hand back to Gowan Pickering just to  
15 continue with our questions relating to the Y benefits.

16 **COMMISSIONER PICKERING:** In terms of a general - I've got one final area I want to  
17 explore. It really goes back to Cavalier and really I'd just like you to go through again  
18 for me what makes the Y value merger specific. In other words, what are we going to  
19 get out of the - again this is leading to the benefits issue. So let me just park that for a  
20 minute and you think about as we go. I just want to make sure there are no more  
21 questions, rights of reply etc required of people here from the previous session. Sorry,  
22 David.

23 **MR STOCK:** Yes, we just want to be sure that the Commission members understand and  
24 accept WSI's position that in their view there is no issue with their quality at all. Their  
25 quality they believe is absolutely equal to or better than that of Cavalier, and the proof  
26 of that, of course, is in the fact that they've got increased commissioned scouring. So  
27 they believe there is no quality issue with the quality of their scouring at all and it is  
28 right up to the top of the market.

29 And they also perceive that the benefits which have been discussed in the  
30 previous session have always been present in the scouring process. So the benefits are  
31 there in any event, and whether you're looking at either the factual or the  
32 counterfactual arguments, the benefits won't change. Those benefits have always been  
33 there, and will continue to be there as the quality keeps on being improved by both



1 parties as part of their normal processes.

2 **MR TAYLOR:** Mr Chairman, just one thing that derives from that, and it's something that  
3 Dr Carnaby said also. Dr Carnaby said there was no comparison between, or no  
4 information provided that enabled a comparison between WSI's wool scouring and  
5 that of CWH.

6 That would be put beyond doubt if WSI were to provide to the Commission the  
7 same scouring information by certified testing that was provided by CWH. So if  
8 exactly the same information was provided then the two could be compared. That  
9 would put the matter beyond doubt. At this stage we're only going on a statement to  
10 that effect.

11 **COMMISSIONER PICKERING:** There has been a lot of comment on the measurements  
12 and that from your side. Do you have information that has any comparison that we  
13 could see?

14 **MR STOCK:** Dr Carnaby's view, as he expressed it to me - and it's a pity he's not here with  
15 us still - was that he could not see any real value in the information that had been  
16 provided by Cavalier to the Commission, and he said that from his analysis of it it  
17 didn't prove anything. And he took the same view of the sort of information that  
18 would be provided by Wool Services. I assume he'll take the same view on it if we're  
19 to provide identical information.

20 **COMMISSIONER PICKERING:** On the other hand you folks say there are trend  
21 informations that you have that shows certain things happening. If they had the trend  
22 information, same trend information, then you might have a comparative.

23 **MR DONNELLY:** Some of that trend information has been presented through some  
24 information that was passed on to Godfrey Hirst, and the information is tested by  
25 testing house results in terms of output colours, but there's no bearing on input colours,  
26 which is the assemblation of the scourments and the inputs to the scourments.

27 We have that data, it's quite a complex task to gather the data, but Cavalier in  
28 their document of issues for consideration have indicated that they don't have the  
29 equivalent greasy data that was available to us, and don't have those records, because  
30 they don't - and have never owned the wool. So for us to do one thing and supply  
31 something when the other can't be supplied is probably irrelevant.

32 **COMMISSIONER PICKERING:** It has to be the same base and I'm struggling a bit at the  
33 moment of what is the same base.

1 **MR TAYLOR:** Perhaps we could put something in writing. Would that be helpful?

2 **COMMISSIONER PICKERING:** Mr Chairman, could I just ask you where you see that  
3 situation?

4 **CHAIR:** I guess the thing that, you know, we've got into a contest argument about one  
5 person saying that they've got a better, you know, standard than the other. But I'd be  
6 very interested to hear just what the actual merger specific benefits are.

7 We're being told that there's going to be a rationalisation, that you're assuming  
8 the plant and operation of a competitor and through that you're going to be able to  
9 achieve a higher level of Y benefits. I'm just wondering if we can get a clearer focus  
10 on just exactly what these merger specific benefits are.

11 **MR TAYLOR:** In simple terms, I think, if I can be allowed to speak for a second on quality,  
12 which may be dangerous; the benefit that's said to flow derives from an increase in  
13 demand for wool to be scoured through CWH as a result of acquiring WSI, there's  
14 more wool to go through. Therefore in order to be able to scour that wool and still  
15 make the rationalisation closures, it's necessary to increase the volume of wool that  
16 can go through, and in order to achieve that the modifications have to take place.

17 **CHAIR:** Why does that translate into a higher Y factor?

18 **MR TAYLOR:** The very same modifications that increase the throughput through how it  
19 deals with dirt, opening, etc, that gives rise to the Y value as a by-product.

20 **COMMISSIONER PICKERING:** But the difficulty we've got at the moment is we can't,  
21 from this conversation I don't think, distinguish this difference that's claimed there  
22 from what is said here. That's what I'm having a little bit of difficulty at the moment.

23 **MR TAYLOR:** Which is why I was suggesting that if WSI were to provide the same  
24 certified scoured and greasy information as CWH has provided and the peroxide uses  
25 that CWH has provided to get those same trend lines, which are all derived from  
26 independent wool testing, then the comparison would be easy.

27 **MR STOCK:** With respect, I think that you can't assess that independently without actually  
28 also having the same information on the inputs. If you have all the inputs lined up as  
29 against the outputs and can do the two trend lines, then you may have something  
30 useful. But when you only have an input line you don't have a - sorry, have an output  
31 line and you don't have an input line, you cannot develop exactly what the trend lines  
32 may be.

33 **MR TAYLOR:** I'm not sure there is actually an input line from WSI. The information that

1 was provided by Godfrey Hirst that the gentleman says he acquired from WSI is only  
2 of clean wool, not greasy wool.

3 **MR DAVID:** And further, Mr Chairman, even if it were the case that the Cavalier provides a  
4 superior service, that's something that's been developed over a ten year period in a  
5 competitive environment. It doesn't address the basic point as to why this  
6 improvement couldn't also be achieved by WSI absent the merger. They could acquire  
7 the technology, they could develop the technology, it could be competition by way of  
8 innovation.

9 **COMMISSIONER PICKERING:** But your claim has turned to all about volumes hasn't it?

10 **MR TAYLOR:** Yes. And if you don't need to increase your volume in order to meet an  
11 increase in scoured wool then you won't carry out the capex alterations that lead to the  
12 improvements.

13 **COMMISSIONER PICKERING:** I'm sorry I interrupted you before, in a sense, but this  
14 measurement thing has bugged me, I'll leave that aside. Please stick to the question  
15 and say as much as you can to the question that the Chair asked I think.

16 **MR TAYLOR:** I think when you look at the counterfactual, the counterfactual will provide  
17 the status quo. And because there is no increase in the wool volumes it will move  
18 through the CWH scours, whether they're in their current state, there's no point in  
19 them, or no drive for them to increase the throughput. No increased demand, no need  
20 for throughput, and that's where the revenue benefit comes for the company.

21 Whereas the Y quality, which is a by-product of that modification carried out  
22 to get that throughput is a benefit for the growers and a benefit for the merchants. It's  
23 not a benefit directly for the company, the benefit for the company is a revenue  
24 increase from volume efficiencies.

25 **COMMISSIONER GALE:** Why wouldn't the benefit be half the 4 cents or something?

26 Why wouldn't the company share in the - if the company had to invest to raise the  
27 quality increment, why wouldn't the company share with the growers that perfectly  
28 wonderful improvement in the product, where somebody has to invest and the grower  
29 will ultimately get a higher price from the buyer in Europe.

30 **MR TAYLOR:** Yeah, well, the immediate value that comes derives only from efficiencies  
31 and therefore the capex is too high, unless those efficiencies also flow at the same time  
32 as the Y value efficiencies. So that means in the counterfactual the Y value doesn't  
33 derive, because neither WSI nor CWH are going to have extra wool, because they're

1 both going to have the wool they're putting through at the current time.

2 So neither of them is going to have a need to increase their throughput. So  
3 they're not going to spend money on increasing their throughput just to get a Y benefit,  
4 most of which, if not all of it, will go to the growers or the merchants.

5 **COMMISSIONER PICKERING:** I've got nothing more to ask on that particular thing.

6 **MR TAYLOR:** There is just one thing that flows from that. There is a third leg to this, that  
7 is the peroxide saving. I'm not sure where the Commission sits on that, there was no  
8 reference to it in the Draft Determination. But that peroxide cost, if WSI were to  
9 provide the Commission with details of that cost, it's an easy assessment to work out  
10 whether there is a value cost saving.

11 **COMMISSIONER PICKERING:** I think, just let me turn to the staff here, I mean we've  
12 always talked about recognising that bleach costs you, and if you're not using as much  
13 bleach it's going to save money. I think there was no question about that.

14 My last point is really, I think I want to take on notice frankly this question of  
15 measurement or not, because I haven't quite got my head around it. I'm going to ask  
16 various people here whether it would do anything for either case. At the moment I'm  
17 not sure that it would. But if you wish to, you know, say more on that matter by all  
18 means.

19 **MR DONNELLY:** Excuse me, just on the breach thing, bleach is used to enhance quality of  
20 wool. But it's also used in relevance to the input that you are given as processor, and  
21 when you're given something that's three colour units different to what the base colour  
22 is and they want an improvement of three colour units, then a certain amount of bleach  
23 will be used. And different exporters can use different blends of wool and use  
24 different volumes of bleach relative to how they make it.

25 So again it comes back, the peroxide on an end result must also be looked at  
26 based on the input and what's been applied by, or wanted by the client.

27 **COMMISSIONER PICKERING:** Yes, exactly that last point - yeah, I understand.

28 **MR DONNELLY:** Thank you.

29 **COMMISSIONER PICKERING:** Okay. So just going back to my comment, I think if I  
30 could park that we'll come back to you if we think there's any advantage. At the  
31 moment I don't quite - I mean I heard all that went on before, I need to read back and  
32 think back through that one with the staff.

33 Now any further commentary at all about quality and what it might do for the

- 1 case? Sir.
- 2 **MR HALES:** Yes, I've just got one question which I didn't immediately pick up on before  
3 that I'd like to revisit if possible please.
- 4 **COMMISSIONER PICKERING:** By all means, yeah, go ahead.
- 5 **MR HALES:** And it's quite an important one. Kevin spoke of data capture. Can you  
6 confirm that that's from the NERA?
- 7 **MR PIKE:** I can't confirm but --
- 8 **MR DONNELLY:** Sorry, the data, it's tested from testing house certificates.
- 9 **MR HALES:** So it's certified information?
- 10 **MR DONNELLY:** It's certified information.
- 11 **MR HALES:** Okay, thank you.
- 12 **COMMISSIONER PICKERING:** Okay, thank you.
- 13 **MR DWYER:** You might find it the best source to your answer is to talk or get a submission  
14 from the test houses.
- 15 **COMMISSIONER PICKERING:** Thank you. All right, if there's nothing further I will  
16 hand back to - sorry.
- 17 **MR CUNNINGHAM:** I'd just like to in some way of summarising, I guess, or maybe  
18 assisting, just to explain the exercise we went through for both sites.
- 19 **CHAIR:** Could you identify yourself?
- 20 **MR CUNNINGHAM:** Sorry, yeah, just to explain --
- 21 **COMMISSIONER PICKERING:** Could you identify yourself for the --
- 22 **MR CUNNINGHAM:** Tony Cunningham for Cavalier. The exercise was pretty simple, we  
23 just looked at the greasy Y values of some scourments that had been done at either site  
24 and we looked at the scoured Y values of those types. We were very careful to choose  
25 no non-bleached lines and we were also very careful to choose a range of categories,  
26 so right from rough oddments to good fleece wool with a big range of Y values.
- 27 In each case we saw a clear improvement in the base Y value and the averages  
28 we came up with were 1.01 in the North Island, 1.08 in the South Island. So just to  
29 bring some reality back in. You know, we can see it scourment by scourment that  
30 there is a good tangible improvement there.
- 31 **COMMISSIONER PICKERING:** Okay, thank you.
- 32 **COMMISSIONER GALE:** Can I clarify you're comparing what and what, WSI scourments  
33 to yours or --

1 **MR CUNNINGHAM:** No, our own scourments within our own plants.

2 **COMMISSIONER GALE:** Yeah, so that's half of the story, though, isn't it.

3 **MR CUNNINGHAM:** I guess it explains, you know, there is something tangible in there.

4 **COMMISSIONER GALE:** Well, if I'm understanding you right, it shows that in the process  
5 of getting greasy wool to clean wool the Y value goes up. But I think you're saying  
6 that you're making it go up more than previously. I think you're saying that if you get  
7 hold of their equipment you can do better than they are in getting the Y value up from  
8 its greasy value to its clean value, if those are the right terms. But we don't know what  
9 is being achieved.

10 **MR DAVID:** Dr Gale, I wonder if we could also ask if we could see how that improved  
11 throughput, that improved enhanced value is relative to throughput. In other words, is  
12 there any correlation between volumes that have been scoured and the enhanced  
13 quality that's come out?

14 **MR HALES:** Yes, that is correct. There is a correlation. Obviously to get higher run rates  
15 you must make mechanical changes to your scour line. We are proposing when we  
16 move the New Zealand Wool Services scour lines to our sites that we will  
17 substantially modify them. Right at the moment you couldn't do it, because Wool  
18 Services have already said that they're at 100 percent capacity and there's been  
19 submissions to back that up. So therefore if they were to stop for a length of time to  
20 make the modifications that we propose, then there is, you know, there's obviously  
21 going to be some down time there.

22 But secondly, we hold IP that's not currently available and we'll be including  
23 that IP into the modifications that we have and that we hold extremely tightly. It's not  
24 off the shelf openers, it's not off the shelf dirt loops or anything like that.

25 **MR DAVID:** That IP presumably could be licensed, Mr Chair, for WSI.

26 **COMMISSIONER GALE:** I think we're at a step before that question.

27 **MR DONNELLY:** I just would like to add one more comment to that. A wool exporter  
28 could also go to a wool sale and visually buy wool that would scour a colour unit  
29 better than its described on its paperwork, would that be fair to say Michael?

30 **MR DWYER:** Absolutely.

31 **MR FOOKES:** I think we're getting confused and unnecessarily complex. The basis of the  
32 measurement of Y value, X, Y and Z values which are the three values of colour  
33 measurement, are done on greasy wool and the greasy wool is prepared in such a way

1 so that it will be the optimum colour potential that that wool can be dyed to. So it is as  
2 white and bright as you can get under normal scouring circumstances. So the greasy  
3 comparison the base comparison is as it would be if it was processed to its optimum  
4 conditions and cleaned optimally.

5 I think what this data is saying, and I can't comment on the validity of how it  
6 actually happens; this data is saying that somehow the Y value has been improved  
7 beyond its potential in the normal test process. So it's actually a process, something  
8 occurs that makes it whiter, or, sorry, brighter, than it would be under normal  
9 circumstances. I think it's pretty simple.

10 And I think, just to reiterate, I think it would be a very good idea to be able to  
11 get a detailed analysis of the ratio of fleece to oddments over a ten year period and to  
12 look at the changes between both organisations. That's the only way I can see of  
13 resolving the arguments.

14 **MR DONNELLY:** There was some other scours involved in that ten year period as well, so  
15 you're complicating the mix of what you might try to achieve there.

16 **COMMISSIONER PICKERING:** Okay, thank you for that. Just helps me to get more  
17 confused. I beg your pardon, I shouldn't say that. But it's obviously a very  
18 complicated arena, and there's a lot of learning that's gone on over some time. But  
19 without being able to share we may not get anywhere.

20 So once again I'll say I'll take it on notice and we'll think about whether there's  
21 anything for the purposes of this exercise we would ask more of, going beyond now  
22 there may well be some things you want to do.

23 Okay, if there's nothing more I'll hand back to the Chairman.

24 **CHAIR:** Okay, that brings an end to today's public sessions, so if we could just have  
25 remaining in the room those persons who have signed the undertakings as to  
26 confidentiality.

27  
28 **Conference adjourns at 4.17 pm to**

29 **Thursday, 5 May 2011 at 9 am**