

Determination

Gebr. Knauf KG and USG Corporation [2019] NZCC 3

The Commission:

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Summary of application: An application from Gebr. Knauf KG and USG Corporation seeking clearance to merge their businesses.

Determination: Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Gebr. Knauf KG and USG Corporation to merge their businesses subject to the divestment undertaking dated 3 April 2019 provided by Gebr. Knauf KG under section 69A of the Commerce Act 1986.

Date of determination: 18 April 2019

Confidential material in this report has been removed. Its location in the document is denoted by [].

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The proposed merger

1. On 20 December 2018, the Commerce Commission (the Commission) registered an application (the Application) under section 66(1) of the Commerce Act 1986 (the Act) from Gebr. Knauf KG (Knauf) and USG Corporation (USG) to merge their businesses (the Proposed Merger).
2. The Application relates to a global merger that has been notified in a number of overseas jurisdictions, including the European Union, the United States, and Australia.
3. Knauf and USG (together, the Applicants) are suppliers of building products both internationally and in New Zealand.

Our decision

4. The Commission gives clearance to the Proposed Merger (subject to the Divestment Undertaking). It is satisfied that the Proposed Merger, together with the Divestment Undertaking, will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

5. Our approach to analysing the competition effects of the Proposed Merger is based on the principles set out in our Mergers and Acquisitions Guidelines.¹

The substantial lessening of competition test

6. As required by the Act, we assess mergers using the substantial lessening of competition test.
7. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).²
8. We make a pragmatic and commercial assessment of what is likely to occur in the future, with or without the merger, based on the information we obtain through our investigation and taking into account factors such as market growth and technological changes.
9. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),³ or to reduce non-price factors such as quality or service below competitive levels.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2013).

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ Or below competitive levels in a merger between buyers.

10. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.
11. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.⁴

When a lessening of competition is substantial

12. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.⁵ Some courts have used the word 'material' to describe a lessening of competition that is substantial.⁶
13. Consequently, there is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

When a substantial lessening of competition is likely

14. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.⁷

The clearance test

15. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.⁸ If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

The parties and the transaction

16. The Proposed Merger would result in Knauf acquiring USG as a wholly-owned subsidiary for approximately USD7 billion.

Knauf

17. Knauf is a multinational company based in Germany that operates globally in the building materials supply industry. It manufactures and supplies a range of products including plasterboard, cement board, metal profiles, plasters, and suspended ceiling components. In New Zealand, Knauf is active in the importation and supply of tiles and grids used for modular suspended ceilings, and insulation products.

⁴ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁵ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

⁶ *Ibid* at [129].

⁷ *Ibid* at [111].

⁸ Section 66(3)(a).

USG

18. USG is a global manufacturer and supplier of building materials headquartered in the United States. USG is active in New Zealand only through its 50% owned joint venture with Boral Limited (Boral), USG Boral Building Products (USG Boral).⁹
19. USG Boral is headquartered in Singapore and is present throughout Asia and the Middle East. It operates as a standalone business and has its own manufacturing and distribution networks, separate from USG. Neither USG nor Boral are active in New Zealand outside of the joint venture. In New Zealand, USG Boral supplies suspended ceiling components and other building materials through third party distributors.
20. USG Boral in turn owns 50% of Rondo Building Services Pty Limited (Rondo), with the other 50% owned by CSR Limited. Rondo manufactures and supplies various metal building products in New Zealand (and Australia), including steel ceiling grids. USG Boral provides a sale and distribution channel for Rondo's metal building products in New Zealand.

Rationale

21. The Applicants submitted¹⁰ that the Proposed Merger is driven by
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AWI transaction

22. Separately from the Proposed Merger, Knauf has entered into an agreement to acquire the EMEA and APAC¹¹ businesses of Armstrong World Industries (AWI), a global manufacturer and supplier of building products including modular suspended ceilings. Knauf anticipates completing this transaction before []. This transaction is subject to regulatory approval in some overseas jurisdictions and was conditionally approved by the European Commission (EC) on 7 December 2018.¹² We have not received an application for clearance relating to this transaction in New Zealand, as Knauf does not consider that it raises competition concerns here.
23. AWI imports and supplies ceiling tiles and grids (through WAVE, its 50% joint venture with Worthington Industries Limited) into New Zealand for resale by a third-party

⁹ USG Boral's New Zealand-registered entity, USG Boral Building Products NZ, is a wholly owned subsidiary of its Australian-registered entity, USG Boral Building Products Pty Limited.

¹⁰ The Application at [14].

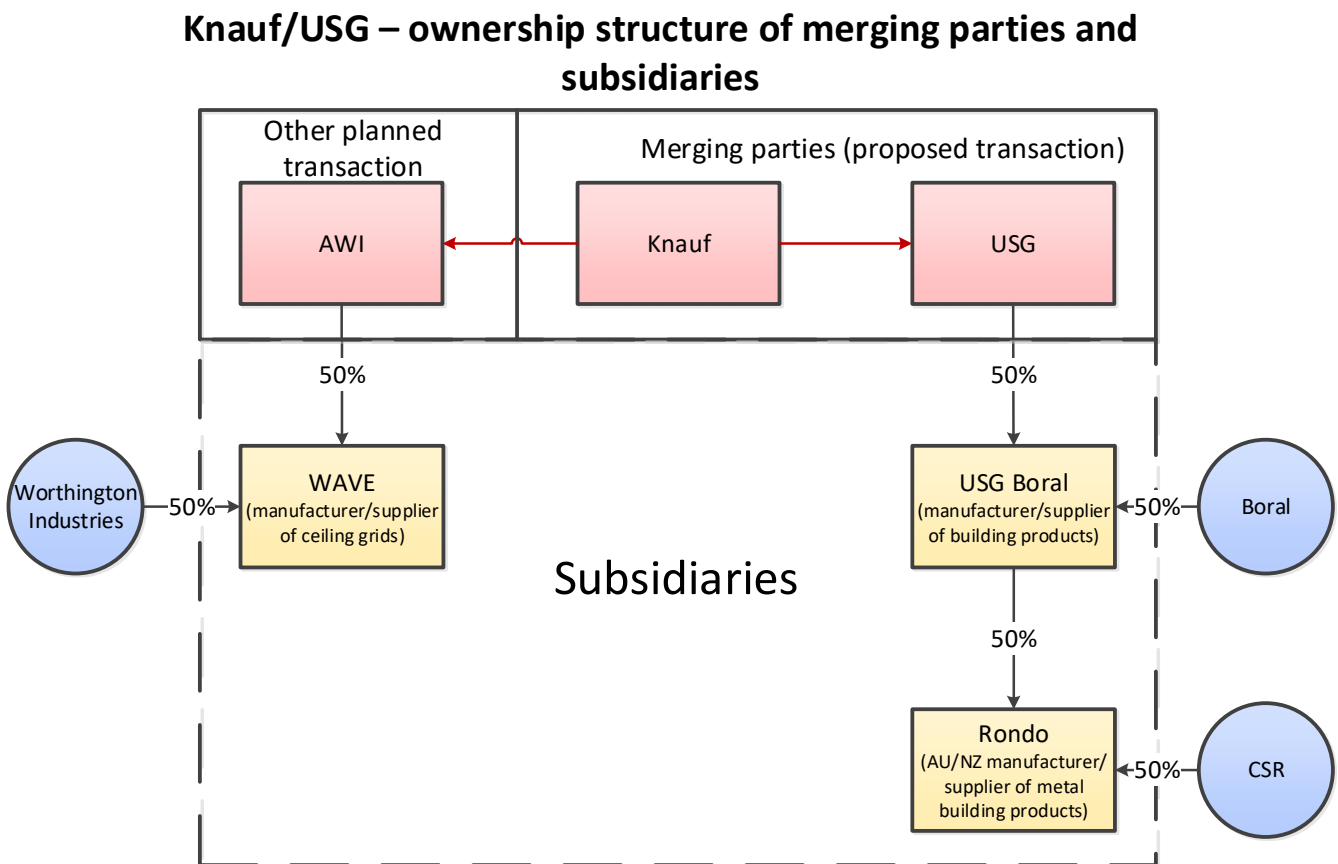
¹¹ Europe, Middle East and Asia (EMEA), and Asia-Pacific (APAC).

¹² See http://europa.eu/rapid/press-release_IP-18-6731_en.htm.

distributor, Forman Building Systems (Formans). The AWI transaction would result in overlap in the supply of modular suspended ceilings in New Zealand.¹³

24. The Applicants submitted,¹⁴ and the Commission agrees, that Knauf and AWI should be treated as a single entity for the purposes of the Commission's competition analysis of the Proposed Merger.
25. Figure 1 below shows the ownership structure of the various entities relevant to the Proposed Merger.

Figure 1: Ownership structure of merging parties and subsidiaries



Other industry parties

26. In addition to the merging parties, there are several other industry parties that are relevant to our consideration of the proposed merger. We provide background on some of these parties below.

¹³ As Knauf has not sought clearance for this acquisition, we have considered it separately as part of our surveillance regime. The Commission's view is that this transaction is unlikely to breach section 47 because of Knauf's limited presence in New Zealand prior to the transaction, with no forecasted significant expansion.

¹⁴ The Application at [49].

Other suppliers

27. In this decision, we use the term ‘supplier’ to refer to New Zealand and overseas manufacturers/suppliers of modular suspended ceilings (such as the merging parties). Other suppliers of modular suspended ceilings include:
- 27.1 Daiken Corporation (Daiken), a Japanese manufacturer of construction materials which supplies mineral fibre ceiling tiles in New Zealand through its distributor, T&R Interior Systems (T&R);
 - 27.2 Rockfon,¹⁵ a global manufacturer of ceiling products which supplies rock wool ceiling tiles in New Zealand through its distributor, Commercial Building Supplies;
 - 27.3 Odenwald Faserplattenwerk GmbH (OWA), a German manufacturer of ceiling products which supplies mineral fibre ceiling tiles in New Zealand through its distributor, Asona Limited (Asona);
 - 27.4 Asona, a New Zealand-based manufacturer of soft fibre ceiling tiles which also operates as OWA’s New Zealand distributor;
 - 27.5 SAS International (SAS), a British manufacturer of interior products which supplies metal ceiling tiles in New Zealand through its distributor, Potters Interior Systems; and
 - 27.6 Compagnie de Saint-Gobain S.A. (Saint-Gobain), a French multinational manufacturer of building materials whose subsidiary, Saint-Gobain Ecophon AB (Ecophon), supplies modular suspended ceilings in multiple countries. Ecophon has previously supplied modest quantities of ceiling tiles in New Zealand but does not currently appear to have its products distributed in New Zealand.

Distributors

28. In this decision, we use the term ‘distributors’ to refer to New Zealand-based building product distributors that purchase from suppliers (mostly via imports) and sell modular suspended ceilings to their customers, such as installers. Distributors of modular suspended ceilings in New Zealand include:
- 28.1 Potter Interior Systems Limited (Potters), which has four locations nationwide and whose suppliers include USG Boral, Knauf and SAS;
 - 28.2 Formans, which has four locations nationwide, is owned by Fletcher Building Limited, and is the exclusive distributor for AWI;
 - 28.3 T&R, which has three locations nationwide and which distributes mineral fibre ceiling tiles from Daiken along with grid from an Italian supplier, CBI Europe (CBI); and

¹⁵ Rockfon is a subsidiary of Rockwool International A/S.

- 28.4 Commercial Building Supplies Limited (CBS), which distributes nationwide through one location in Auckland and is the only New Zealand distributor of Rockfon's rock wool ceiling tiles.

Customers

29. In this decision, we use the term 'customers' to refer to the installers, building contractors, and developers who purchase modular suspended ceilings from distributors.¹⁶

Architects and specifiers

30. In this decision, we use the term 'architects and specifiers' to refer to the industry experts who often assist customers to choose modular suspended ceiling products and specify on the building plan which products are to be used.

Industry background

31. Knauf and USG Boral compete in New Zealand only in the supply of modular suspended ceiling components (grids and tiles).
32. Modular suspended ceilings are generally used in commercial buildings to conceal technical equipment such as heating, ventilation and air conditioning ducts, lighting fixtures, sound systems and wireless antennae, as well as for other functional purposes (such as sound absorption and blocking). The cavity created is the main functional difference between modular suspended ceilings and fixed ceilings; the latter are affixed directly to the soffit and therefore do not allow for a ceiling cavity in which technical equipment and services may be installed.
33. A modular suspended ceiling system is comprised of two products: grid and tiles. These are typically manufactured separately but assembled into the system on site when tiles are laid into the grid.
34. Grids for modular suspended ceilings are typically made from roll-formed steel or aluminium, while tiles can be made from a variety of materials including mineral fibre, glass fibre, rock wool, metal, wood, and plasterboard. These materials differ in their acoustic properties, aesthetic, and price. Our market inquiries have indicated that most modular suspended ceilings (around 75%) use mineral fibre tiles.¹⁷
35. While limited manufacturing of modular suspended ceiling products occurs in New Zealand (for example, Asona manufactures tiles and Rondo manufactures grid), manufacturers typically do not have a presence here. Customers are mostly supplied by New Zealand distributors, who import product from overseas suppliers.
36. The suppliers with a significant presence in New Zealand are large, multinational companies with significant manufacturing assets in multiple countries. For example,

¹⁶ The vast majority of the Applicants' sales into New Zealand go through distributors, with only a very small amount being sold direct to customers.

¹⁷ Commerce Commission interview with [] (17 January 2019); Commerce Commission interview with [] (15 January 2019); Commerce Commission interview with [] (15 January 2019).

[]¹⁸ Similarly,
 []¹⁹ Access to large-scale manufacturing is a requirement for a supplier to compete effectively in New Zealand.

37. The applications of modular suspended ceilings include offices, schools, and other commercial buildings. Customers purchase products from distributors subject to the specifications of an architect or specifier. Market participants have suggested that architects sometimes, and increasingly, specify products from a particular supplier, which are pre-tested for seismic compliance purposes. This often makes it difficult for the installer to elect to use a different product without needing to retest the seismic properties of the ceiling with that alternative product, increasing costs.
38. According to industry parties,²⁰ customers choose modular suspended ceilings based on the following factors.
- 38.1 The tile used must have the appropriate acoustic properties for the intended application. For example, office environments typically require a tile that is good at both absorbing sound (the tile's noise reduction coefficient, or NRC) and preventing sound from travelling between enclosed spaces (the tile's ceiling attenuation class, or CAC). Mineral fibre has a good balance of NRC and CAC, which appears to be the reason it is used in most office buildings.
- 38.2 The seismic strength of the modular suspended ceiling must meet the New Zealand building code.
- 38.3 Appearance.
- 38.4 Reputation of the manufacturer.
- 38.5 Fire resistance.
- 38.6 Price.

Market definition

The Applicants' view of the relevant markets

39. The Applicants submitted that the relevant market is the national market for the wholesale supply of modular suspended ceilings.²¹

Past Commission decisions

40. The Commission last considered similar (but not identical) markets in its 2014 decision granting clearance for USG and Boral to form the USG Boral joint venture.²²

¹⁸ [] response to Commerce Commission information request (15 October 2018).

¹⁹ [] response to Commerce Commission information request (26 September 2018); Commerce Commission interview with [] (2 April 2019).

²⁰ Commerce Commission interviews with [] (7 February 2019); [] (15 January 2019); [] (17 January 2019); and [] (11 April 2019).

²¹ The Application at [45].

In that decision, we defined a discrete product market for the manufacture/importation of steel roll-formed exposed ceiling grid. We were not required to address the question of a broader market encompassing both grids and tiles.

The Commission's view of the relevant markets

41. We consider that the appropriate market for our analysis of the Proposed Merger is the national market for the manufacture/importation and wholesale supply of modular suspended ceiling systems.

Systems vs components

42. While some suppliers in New Zealand offer only grids or only tiles and most tiles can fit within most grids, our understanding is that competition to supply New Zealand distributors occurs primarily between suppliers that can supply complete systems, ie, both grids and tiles together.

43. Customers can and sometimes do purchase grids and tiles from different manufacturers. However, this appears to happen when a system requires a tile with a particular look or function which can only be achieved by using a certain tile material. In these situations, a customer may be more likely to use a specialist tile supplier such as SAS (metal tiles) or Asona (soft fibre tiles) with a different supplier's grid.

[]²³

44. For most modular suspended ceilings, customers and architects prefer to use tiles and grids from the same supplier due to regulatory standards, warranties offered by manufacturers, and reduced costs.

44.1 Industry parties consistently advised that mixing tiles and grids from different suppliers is likely to raise the cost of installing a modular suspended ceiling. This is because the entire modular suspended ceiling system must comply with seismic requirements in the New Zealand Building Code, rather than just the grids or just the tiles. Suppliers that supply both grids and tiles typically provide a producer statement assuring that the system meets seismic design requirements. This reduces the need for specialist input in the building consent process. Using tiles and grid from different suppliers requires added engineering input to ensure that the ceiling has sufficient seismic strength.

44.2 [], an architectural firm, told us that it strongly prefers specifying systems from one supplier rather than having to "mix-and-match" tiles and grids.²⁴ This is because it can rely on a single producer statement and warranty for the system. Where grids and tiles from different suppliers are mixed and matched, responsibility for quality and performance of the ceiling is less easily allocated, increasing risk for both the specifier and the customer

²² USG Corporation and Boral Limited [2014] NZCC 4.

²³ Commerce Commission interview with [] (15 January 2019).

²⁴ Commerce Commission interview with [] (11 April 2019).

should a product prove to be faulty. Costs for the architect are also increased through the need to liaise with more suppliers and to assess the compatibility of different products.

- 44.3 [] advised that it typically sells tiles and grids together as packages from the same supplier.²⁵ It further advised that, with seismic requirements becoming more stringent, suppliers will only guarantee their chosen combinations of grid and tiles; they are not willing to guarantee their tiles with someone else's grid.
- 44.4 [] told us that modular suspended ceilings are typically supplied as a whole system including grids and tiles.²⁶ Further, it noted that it would be difficult for other tile suppliers to compete with the merged entity because they only sell one of the products in the system (tiles and not grids). On the other hand, the merging parties both sell full systems and have engineering statements to support their products. [] indicated that in New Zealand it is hard to supply only tiles because the whole system needs to have seismic certification.
- 44.5 [] confirmed this. It advised that it tends to sell modular suspended ceilings to building contractors as a package from a single supplier.²⁷ Further, [] advised that customers are incentivised to do this as suppliers provide longer warranties for their products if customers use their grids and tiles together.
- 44.6 [] advised that recent seismic events in New Zealand have resulted in stricter building code standards and have affected the likelihood of customers using grids from one supplier and tiles from another.²⁸ It told us that different tiles have different weights and characteristics, so the engineer needs to have confidence about how the ceiling will behave during an earthquake. Further, [] advised us that suppliers of systems have run tests on their grid and tile combinations and have data on how they perform.
45. For these reasons, we consider it unlikely that distributors would switch from suppliers of a system to suppliers offering only tiles or only grids in response to a small increase in price.²⁹ We therefore consider that the relevant product market is best defined in terms of a system comprising both grids and tiles.

²⁵ Commerce Commission interview with [] (17 January 2019).

²⁶ Commerce Commission interview with [] (7 February 2019).

²⁷ Commerce Commission interview with [] (7 February 2019).

²⁸ Ibid.

²⁹ In assessing the product dimension of a relevant market, we look for evidence showing which products customers regard as close substitutes, and whether they would switch sufficient purchases to those products to make it unprofitable for a supplier to implement a small but significant increase in price. For more information on why and how we define a market, see: Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2013).

Different types of tiles within modular suspended ceiling systems

46. As noted above, modular suspended ceiling systems can be fitted with tiles of different materials. Our market inquiries provided mixed evidence on the substitutability between different ceiling systems that use tiles made of different materials (such as a system with mineral fibre tiles or a system with metal tiles).
47. As noted, mineral fibre appears to be by far the most common material used in modular suspended ceilings. Market feedback suggested that other materials, such as glass fibre, rock wool and metal, may be imperfect substitutes for mineral fibre. For example, we heard from some market participants that office buildings often require mineral fibre tiles due to their ability to prevent sound travelling between enclosed spaces.³⁰ Alternative materials are typically more expensive and, as noted above, tend to be used in more specialised situations. For example, metal tiles may be used in a foyer where a certain aesthetic is desired. Likewise, soft fibre tiles may be used in a classroom where high sound absorption is required, but with no requirement to prevent noise travelling between different enclosed spaces (ie, like offices in a corporate environment).
48. However, some market participants suggested that there is some substitutability between systems with different tile materials. For example:
- 48.1 [] indicated that it believes its product to be a close substitute for mineral fibre tiles;³¹
- 48.2 [] described Rockfon's tiles as good and suggested that they would be a substitute for mineral fibre tiles;³² and
- 48.3 [], a specialist supplier of tiles, suggested that tiles are generally substitutable, with the key issue being the acoustic properties of the tile.³³
49. We have not found it necessary to reach a firm conclusion on whether it may be appropriate to define narrower, tile material-specific markets for ceiling systems. On either approach to market definition the constraints would be the same, with the Applicants as each other's closest competitors and by far the largest suppliers in the market. Our decision does not depend on the precise boundaries of the product market.

Relevant level of the supply chain

50. Knauf imports the tiles and grid that it wholesales to distributors in New Zealand. AWI also imports its systems and wholesales them to distributors. USG Boral imports its ceiling tiles and manufactures grid in New Zealand through its 50% interest in Rondo. Accordingly, we consider the relevant level of the supply chain is manufacture/importation and wholesale supply.

³⁰ Commerce Commission interview with [] (17 January 2019).

³¹ Commerce Commission interview with [] (25 March 2019).

³² Commerce Commission interview with [] (7 February 2019).

³³ Commerce Commission interview with [] (15 January 2019).

Geographic scope of the market

51. As the majority of tiles and grids supplied in New Zealand are imported and supplied across the whole of New Zealand, we consider that the geographic scope of the market is likely to be national.

Conclusion on market definition

52. We therefore consider that the appropriate market for our analysis of the Proposed Merger is the national market for the manufacture/importation and wholesale supply of modular suspended ceiling systems.

With and without scenarios

53. With the Proposed Merger, Knauf (including AWI) and USG would become a single entity. As such, Knauf would take over USG's role as joint owner of USG Boral and any competition between Knauf (including AWI) and USG Boral would be lost.
54. The Commission considers that, absent the Proposed Merger, Knauf (including AWI) and USG (via USG Boral) would continue supplying modular suspended ceilings in competition with each other.

How the merger could substantially lessen competition

55. We have considered whether the Proposed Merger could substantially lessen competition by giving rise to:
- 55.1 unilateral effects, where a merger allows the merged entity to profitably raise prices or reduce quality to its customers; and
- 55.2 coordinated effects, where a merger increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour such that output reduces and/or prices increase across the market.

Competition analysis – unilateral effects

Current competition

56. The Commission considers Knauf (including AWI) and USG Boral to be each other's closest competitors and that current competitors would not place a close competitive constraint on the merged entity.

High market shares relative to other suppliers

57. Feedback from market participants supports the market share estimates provided in the Application. These estimates showed high market shares in the supply of modular suspended ceilings for the merging parties, in contrast with comparatively low shares for other suppliers. These market share estimates include sales of grids and tiles that have not been sold as systems, which, as discussed above, are unlikely to impose a strong constraint on the merging parties. As such, we consider that the merging parties' shares of supply for the manufacture/importation and wholesale

supply of modular suspended ceiling systems in New Zealand is likely to be even higher.

- 57.1 Industry participants consistently estimated the merging parties to have combined market shares of [] for modular suspended ceilings in New Zealand.
- 57.2 [] advised that AWI, USG Boral, and Knauf account for approximately [] of its sales.
- 57.3 Table 1 displays market share estimates for the wholesale supply of grids and tiles for modular suspended ceilings in New Zealand, based on estimates provided in the Application and on market feedback. As noted above, this includes sales from suppliers that do not supply a complete system. We understand from market participants that the total value of modular suspended ceiling products is approximately NZD13 million per annum although this can fluctuate slightly from year to year, depending on events such as rebuilding after natural disasters.

Table 1: Market share estimates for the wholesale supply of grids and tiles for modular suspended ceilings in New Zealand for 2017

Supplier	NZ distributor	Modular suspended ceiling products supplied in New Zealand	Estimated share (%)
Armstrong World Industries (AWI)	Forman Building Systems	Systems comprising both tiles and grid (range of tile materials)	[]
USG Boral (including Rondo)	Potter Interior Systems	Systems comprising both tiles and grid (mostly mineral fibre tiles)	[]
Knauf	Potter Interior Systems	Mineral fibre tiles Small amount of grid	[]
Daiken	T&R Interior Systems	Tiles only (mineral fibre)	[]
Rockfon	Commercial Building Supplies	Tiles only (rock wool)	[]
Asona	Asona	Tiles only (rock wool, glass fibre)	[]
SAS International	Potter Interior Systems	Tiles only (metal)	[]
Other (e.g. OWA, Ecophon, CBI)			[]
Total			100
Merging parties total			[]

Source: The Applicants and Commission interviews with industry participants

Advantage of supplying a complete system

58. Both AWI and USG Boral offer complete modular suspended ceiling systems which, as described above, customers appear to prefer over mixing grids and tiles from different suppliers.
59. We note that Knauf only commenced supply of ceiling grid into New Zealand in 2017, in relatively small quantities. It stated in the Application that it typically does not supply grid.³⁴
[].
60. Both AWI and USG Boral offer a wide range of commercial and office tiles and are known and trusted by industry specialists. Several other suppliers are more specialised and limited in range, such as SAS International, which supplies only metal tiles, and Rockfon, which supplies only rock wool tiles.
61. Our inquiries suggest that AWI and USG Boral closely compete for customer projects through Potters and Formans, New Zealand's two largest distributors of modular suspended ceilings.
- 61.1 [] told us that it currently benefits from competition between Potters and Formans (and effectively between AWI and USG Boral) for larger jobs of over 1000 square metres.³⁵ For these jobs, [] advised that it is typically able to play Potters and Formans off against each other to secure better prices. [] further told us that if the merged entity consolidated its distribution post-merger, this ability would be lost.
- 61.2 [] identified [], AWI and USG Boral, as the two strongest competitors in the supply of modular suspended ceilings.³⁶
- 61.3 [] advised that AWI and USG Boral are the suppliers it uses most often. []³⁷
62. That customers consider AWI and USG Boral to be close substitutes for each other suggests that they place a strong competitive constraint on each other against price increases at the wholesale level or deteriorations in some aspects of quality.

³⁴ Application at [22.1].

³⁵ Commerce Commission interview with [] (7 February 2019).

³⁶ Commerce Commission interview with [] (17 January 2019); Commerce Commission interview with [] (7 February 2019).

³⁷ Commerce Commission interview with [] (11 April 2019).

[].

Merging parties established as reliable suppliers

63. AWI and USG Boral appear to have an advantage over other suppliers as they are well-established as the preferred options for modular suspended ceiling systems in the building industry. Industry parties consistently advised that existing relationships between distributors, specifiers, and building contractors heavily influence choice of product in the building industry.³⁸ AWI and USG Boral-branded products are the main offerings of the two largest distributors in New Zealand, both of which distribute a range of interior systems and have strong industry relationships.
64. Our interviews with architects support the view that the merging parties have a significant incumbent advantage through their existing reputation and industry relationships. For example, [] advised that the names of USG Boral and AWI come up very quickly in any project discussion, and that architects prefer using products that are well-established and have a proven history of reliability.³⁹
65. Alternative suppliers have a significantly smaller presence in New Zealand than the merging parties and there appear to be no other manufacturers supplying a system. Other suppliers do not offer the combination of scale, distribution presence, established brand and seismic testing that would be necessary to provide enough competitive constraint on the merged entity to prevent a price rise or reduction in quality (including reductions in service levels) post-merger.

Constraint from entry or expansion

66. In considering potential constraints on a merged entity by entry and/or expansion, we assess whether entry by new competitors or expansion by existing competitors is likely to be sufficient in extent and timely enough to constrain the merged entity and prevent a substantial lessening of competition. This is referred to as the 'LET' test.⁴⁰
67. The Applicants submitted that barriers to entry for importing modular suspended ceiling systems are low and that the merged entity would be constrained by the significant volume of independent imports.⁴¹
68. We note that a number of products supplied by the merging parties are currently imported and as such, there do not appear to be significant barriers to the importing of modular suspended ceiling products. However, to provide an effective constraint on the merged entity in New Zealand, we consider a new or expanding supplier of modular suspended ceilings would need to provide at least:

68.1 a system comprising both grids and tiles;

³⁸ See, for example, Commerce Commission interview with [] (15 January 2019) and Commerce Commission interview with [] (11 April 2019).

³⁹ Commerce Commission interview with [] (11 April 2019).

⁴⁰ *Mergers and Acquisitions Guidelines*, above n1 at [3.95].

⁴¹ The Application at [75]-[83].

- 68.2 the ability to demonstrate that the seismic strength of its ceiling systems meets the New Zealand Building Code in order to gain trust with architects and specifiers;
- 68.3 a well-established brand name with a reputation for reliability among industry specialists such as architects and building consent authorities;
- 68.4 a physical distribution presence or access to a major nationwide distributor; and
- 68.5 a comparable range of tiles to the merging parties.
69. We consider it unlikely that there are prospective new entrants with the ability to satisfy these requirements or that existing competitors are likely to expand to an extent that would constrain the merged entity within a sufficient timeframe.
70. Potential entry or expansion into the supply of modular suspended ceiling systems in New Zealand could occur either by a supplier currently only supplying tiles expanding to also supply grids, or by new entrants. Market participants suggested that there were a number of significant barriers to such entry or expansion.
- 70.1 [], advised that developing a credible reputation with architects takes many years, particularly in an area where there are specific performance requirements (ie, acoustic and seismic needs).⁴² As architects bear the responsibility for ensuring a construction project meets the building code, there is a reluctance to take a risk on new or unproven products.
- 70.2 [] further advised that while architects may have a perception of cost, they do not spend a lot of time thinking about it when specifying products.⁴³ Instead, architects are more concerned with factors relating to product quality, design, technical information, reputation, and helpfulness of supplier representatives. This is supported by [] factors that architects take into account when specifying products.⁴⁴ [] confirmed that the primary consideration for specifiers is the ability to rely on product quality.⁴⁵
- 70.3 [] uses a conservative vetting system to identify suppliers that it is comfortable specifying, which was developed due to previous issues with product quality. [] are the only modular suspended ceiling suppliers that have satisfied this vetting process (as noted, [] competes at the distribution level rather than the wholesale level).

⁴² Commerce Commission interview with [] (11 April 2019).

⁴³ Ibid.

⁴⁴ [], provided to the Commerce Commission 11 April 2019.

⁴⁵ Commerce Commission interview with [] (11 April 2019).

70.4 [] told us⁴⁶ that it would be “a long and difficult road” for a new entrant to establish a competing product and pressure the merged entity.

71. Rockfon, Daiken, and OWA are all global suppliers that have a limited presence in New Zealand currently. We do not consider that these suppliers are likely to expand to a sufficient extent and in sufficient time to constrain the merged entity.

71.1 Rockfon, which has a small presence in New Zealand [], supplies only tiles made from rock wool and does not supply grid in New Zealand.⁴⁷

71.2 Daiken’s mineral fibre ceiling tiles appear to have a good reputation for quality. However, it does not supply grid in New Zealand and has a smaller presence, without the brand awareness of AWI and USG Boral.⁴⁸

71.3 OWA has recently established a distribution arrangement with Asona for its mineral fibre tiles. OWA produces tiles but does not supply grid.
[]⁴⁹

71.4 As mentioned above, [] advised that it would be difficult for other tile suppliers to compete with the merged entity without supplying a full, seismically tested system.⁵⁰

72. []

] ⁵¹

73. []

] ⁵² As noted above, as well as showing that their system meets the relevant requirements, a prospective supplier would also need to gain reputation and acceptance among architects and specifiers. As outlined above, this process can take several years.

⁴⁶ Commerce Commission interview with [] (7 February 2019).

⁴⁷ Commerce Commission interview with [] (25 March 2019); Commerce Commission interview with [] (15 February 2019).

⁴⁸ Commerce Commission interview with [] (7 February 2019); Commerce Commission interview with [] (24 January 2019); Commerce Commission interview with [] (17 January 2019).

⁴⁹ Commerce Commission interview with [] (15 January 2019).

⁵⁰ Commerce Commission interview with [] (7 February 2019).

⁵¹ Commerce Commission interview with [] (25 March 2019).

⁵² Ibid.

74. We have attempted to contact Daiken and OWA for interviews but have been unsuccessful. Given the barriers outlined by architects, installers, distributors and other suppliers, we do not consider it likely that either of these suppliers is likely to expand to a sufficient extent, in a sufficient timeframe, to prevent the merged entity from unilaterally exercising market power.
75. It appears unlikely that new imports from other overseas manufacturers will provide an effective constraint post-merger.
- 75.1 [] advised that they have previously attempted to import tiles and grids from suppliers in China and have had issues in doing so; shipments have frequently resulted in inconsistent quality and faults.⁵³
- 75.2 Industry parties have consistently told us that it would be difficult to find alternative suppliers with reliable quality. New product is viewed with suspicion in the industry due to its perceived inferior quality.⁵⁴
- 75.3 As discussed, importing tiles or grids alone is unlikely to constrain the merged entity.
76. We acknowledge the possibility that new sources of supply of modular suspended ceiling systems may emerge. For example, it is possible that, given sufficient time, global suppliers such as Rockfon and Daiken may expand their presence in New Zealand and compete more directly with the merged entity. It is also possible that existing New Zealand distributors might expand their offerings to constrain the merged entity.
[]⁵⁵
[]
77. However, given the barriers already discussed, we consider it unlikely that any such entry would occur within two years of the Proposed Merger. That is, the period required for an existing or new competitor to effectively constrain the merged entity would be too long to prevent a substantial lessening of competition in the meantime.
78. In conclusion, we do not consider that entry or expansion would occur to a sufficient extent, within a sufficient timeframe, to prevent the merged entity from unilaterally raising prices or reducing quality.

Constraint from countervailing power

79. The Applicants submitted that significant countervailing power is exercised by distributors through their ability to secure supply from a range of sources, and by

⁵³ Commerce Commission interview with [] (7 February 2019); Commerce Commission interview with [] (17 January 2019).

⁵⁴ Commerce Commission interview with [] (11 April 2019); Commerce Commission interview with [] (11 April 2019).

⁵⁵ Commerce Commission Interview with [] (15 January 2019).

architects, specifiers, and installers, in their ability to influence purchasing decisions.⁵⁶

80. We have not found evidence to suggest that distributors would be able to discipline a price increase or reduction in quality from the merged entity, either by sponsoring entry by alternative suppliers or by using other levers. Rather, our inquiries to date suggest that distributors are unlikely to have sufficient countervailing power to constrain the merged firm.
- 80.1 [] advised that if its supplier [] raised the wholesale price of modular suspended ceilings, it would be forced to attempt to pass the increase on to its customers.⁵⁷
- 80.2 [] advised that the merged entity could “absolutely” raise wholesale prices. The merged entity would be in a strong position with [] market share to increase prices to distributors.⁵⁸
- 80.3 [] expressed concern about the power that the merged entity would have over New Zealand distributors due to the lack of alternative suppliers. [] supported this view, stating that the merged entity would have leverage over distributors. It could choose to drop one or the other and only use one distributor, or it could cut them both out and self-distribute.⁵⁹
81. As noted above, new sources of supply of modular suspended ceiling systems may emerge over time. It is therefore possible that sponsorship of a new or expanding supplier by distributors may occur. However, we do not consider that this is likely within two years of the Proposed Merger and therefore would not prevent a substantial lessening of competition.
82. The Commission also does not consider that architects, specifiers, sub-contractors, and installers would exercise countervailing power to constrain the merged entity. Our inquiries have indicated that these parties would not have the ability or incentive to change their product selection to discipline a price increase by the merged entity. Rather, these parties are incentivised to preserve their reputation by relying on quality products.
83. In conclusion, we do not consider that the merged entity would be sufficiently constrained by countervailing power to prevent it from unilaterally raising prices or reducing quality.

Conclusion on unilateral effects

84. On the basis of:

⁵⁶ The Application at [84]-[92].

⁵⁷ Commerce Commission interview with [] (17 January 2019).

⁵⁸ Commerce Commission interview with [] (24 January 2019).

⁵⁹ Commerce Commission interview with [] (7 February 2019).

- 84.1 the loss of competition between the merging parties;
- 84.2 the lack of sufficient competitive constraint from existing competitors;
- 84.3 barriers to entry and expansion; and
- 84.4 the lack of constraint from countervailing power,

the Commission concludes that the Proposed Merger would be likely to result in a substantial lessening of competition through unilateral effects in the national market for the manufacture/importation and wholesale supply of modular suspended ceiling systems.

Competition analysis – coordinated effects

- 85. We have assessed whether the Proposed Merger is likely to increase the potential for the merged entity to coordinate with its competitors.
- 86. While there are currently two major suppliers of modular suspended ceiling systems of similar size, post-merger there would be only one (the merged entity). The remaining suppliers are smaller in size and do not supply homogenous products. For example, Daiken, OWA, Rockfon and SAS all supply ceiling tiles only, made from a variety of different materials. Therefore, there would be a lack of feasible coordination partners for the merged entity.
- 87. Additionally, our investigation has not indicated other market features that appear likely to support coordination.⁶⁰ For example, prices charged by suppliers to distributors are not transparent, and remaining suppliers are not interrelated through cross-ownership.
- 88. For these reasons, we do not consider that the Proposed Merger would be likely to substantially lessen competition through coordinated effects.

The divestment undertaking

- 89. In response to our Letter of Issues to the Applicants,⁶¹ on 3 April 2019 Knauf provided the Commission with an undertaking to divest certain assets (the Divestment Undertaking). A copy of the Divestment Undertaking is provided as **Attachment A**.
- 90. Knauf proposes to divest:
 - 90.1 either its entire interest in USG Boral Building Products Pty Limited⁶² (USG Boral's Australian business) and its wholly owned subsidiary, USG Boral

⁶⁰ For more information, see *Mergers and Acquisitions Guidelines*, above n1 at [3.89].

⁶¹ Commerce Commission Letter of Issues to Knauf and USG (13 March 2019), available at: https://comcom.govt.nz/_data/assets/pdf_file/0010/130420/Gebr.-Knauf-KG-and-USG-Corporation-Letter-of-Issues-13-March-2019.PDF.

⁶² Incorporated in Australia.

Building Products NZ,⁶³ including all intellectual property rights, assets and contracts (the Main Divestment); or

90.2 if, after [], the Main Divestment has not occurred, as a fall-back option, Knauf would divest (the Fall-back Divestment), []

[⁶⁴

⁶⁵]

91. The USG Boral Shareholders Agreement⁶⁶ provides Boral, in certain circumstances, with a right to purchase USG’s share of USG Boral. This right was triggered by the Proposed Merger.

[]

92. We cannot rule out that there is a real chance of the Fall-back Divestment occurring. However, the Fall-back Divestment will only take place if the Main Divestment does not occur within []. Knauf submitted that it is unlikely the Fall-back Divestment option will be needed as it expects the Main Divestment to occur.⁶⁷ Given [] and Boral’s publicly stated consideration of the potential purchase,⁶⁸ we agree that this scenario appears the most likely. The Main Divestment could occur either by Boral exercising its option to purchase the whole USG share of USG Boral, or by Boral (or another approved purchaser) purchasing the Main Divestment business (which comprises USG Boral’s Australasian businesses only).

93. The Main Divestment would result in the New Zealand business of USG Boral (as a subsidiary of its Australian business) being sold to Boral or another independent purchaser. The Fall-back Divestment would result in

[]

94. [] would remove the overlap between Knauf (including AWI) and the acquired business of USG in the

⁶³ Incorporated in New Zealand.

⁶⁴ []

⁶⁵ []

⁶⁶ Provided to the Commission on 20 December 2018.

⁶⁷ Knauf submission to the Commerce Commission on remedy proposals (4 March 2019).

⁶⁸ []; Boral media release (25 February 2019), available at: https://www.boral.com/sites/corporate/files/media/field_document/1H19-Media-Release-2.pdf.

manufacture/importation and wholesale supply of modular suspended ceilings in New Zealand.

95. If either the Main Divestment or Fall-Back Divestment is completed as proposed, and the new owner of the divested assets is able to obtain supply of the relevant products on competitive terms, it is likely to create a credible and sustainable competitor capable of constraining the merged entity in the modular suspended ceiling market in New Zealand.

96. However, in both the Main Divestment and the Fall-back Divestment scenarios,
[]

97. The Australian Competition and Consumer Commission (ACCC) has accepted an undertaking from Knauf (the ACCC Undertaking) that imposes supply obligations on Knauf in respect of the purchaser of the Main Divestment business (the Supply Agreement). Specifically, in the ACCC Undertaking at Schedule 4A, clause 2, Knauf commits to:⁶⁹

[

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98.

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]

99. The Commission is unable to accept behavioural undertakings in the context of its consideration of a merger. However, in assessing whether the Divestment Undertaking will remedy our competition concerns, we have taken into account the likely implications of the ACCC Undertaking for the supply of modular suspended ceiling products into New Zealand.

⁶⁹ ACCC Undertaking at Schedule 4A, clause 2.

⁷⁰ []

⁷¹ []

⁷² []

Our approach to considering the Divestment Undertaking

100. In considering whether the Divestment Undertaking will be sufficient to restore competition to the relevant market, we have had regard to our guidelines⁷³ as well as international best practice as set out in the International Competition Network Merger Remedies Guide 2016.⁷⁴ In addition, we have had regard to the practices of other jurisdictions.⁷⁵
101. Where we consider that a merger is likely to substantially lessen competition in the relevant market(s), we consider whether the proposed divestment undertaking will remedy any likely substantial lessening of competition. For a divestment undertaking to remedy competition concerns, we must be satisfied that the divestment will result in sufficient competitive constraint on the merged firm so that a substantial lessening of competition is no longer likely.
102. In making this assessment, we consider the relevant risks associated with divestment proposals. These risks arise because a divestment will occur in the future. Therefore, there will always be some uncertainty about a divestment's likely impact on the relevant market. It follows that there will also be some uncertainty whether a divestment will actually remedy the competition concerns raised by the merger.
103. In order to assess these divestment risks, we compare the situations with and without the divestment undertaking. We assess whether the divestment would, of itself, or in combination with other market conditions, likely remedy the competition concerns that have been identified.
104. To consider whether the Divestment Undertaking restores competition sufficiently, we assessed the proposed divestment in relation to three types of risks:
- 104.1 Asset risk – the risk that the competitive effectiveness of a divestment package will deteriorate prior to completion of the divestment.
- 104.2 Composition risk – the risk that the scope of a divestment undertaking may be too constrained, or not appropriately configured, to attract a suitable purchaser, or that the contents of a divestment would not sufficiently restore competition.
- 104.3 Purchaser risk – the risk that there may not be a purchaser acceptable to the Commission available and/or the risk that the applicant has an incentive to sell to a weak competitor.

⁷³ *Mergers and Acquisitions Guidelines*, above n1 at Attachment F.

⁷⁴ Available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc1082.pdf>.

⁷⁵ EC notice on remedies (2008), available at: <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:267:0001:0027:EN:PDF>; Richard Feinstein, *Negotiating Merger Remedies: Statement of the Bureau of Competition of the Federal Trade Commission* (January 2012); *The FTC's Merger Remedies 2006-2012, A Report of the Bureau of Competition and Economics* (January 2017).

ringfencing and hold separate provisions are appropriate and will mitigate the asset risk associated with the divestiture.

Composition risk

110. Composition risk is the risk that a divestment proposal may be too limited in scope, or not appropriately configured, to attract either a suitable purchaser or to allow a successful business to be operated in competition with the merged entity.
111. Knauf submitted⁷⁹ that a purchaser would:
- 111.1 have all the local assets necessary to continue operating the divested business as a going concern;
 - 111.2 be able to negotiate competitively for supply arrangements; and
 - 111.3 be able to rely on Knauf's undertaking to the ACCC that, on request, Knauf must provide a supply agreement on terms approved by the ACCC.
112. We understand that USG Boral has a limited physical presence in New Zealand
[]
113. In our assessment of the composition risks we have specifically considered the sufficiency of:
- 113.1 the divestment assets; and
 - 113.2 the ability of the Approved Purchaser to obtain adequate supply of modular suspended ceiling systems.

Structure of proposed divestments

114. [] We have considered the sufficiency of the composition of both the Main Divestment and the Fall-back Divestment.

Main Divestment

115. Knauf submitted that USG Boral Australasia has been and would remain, self-sufficient. It was wholly owned by Boral until 2014, when it was amalgamated into the global USG Boral joint venture.
[]

⁷⁹ Knauf submissions to the Commerce Commission on remedy proposals (4 March, 18 March, 27 March and 5 April 2019).

] Knauf

submitted that the Australasian businesses could easily be stand-alone or report to Boral leadership.

116. We consider that in the scenario where the Main Divestment occurs and the Australasian business of USG Boral is acquired by Boral, the business would be sufficiently complete and independent to function as a standalone business. Boral, as a global construction company and the previous owner of USG Boral Australasia, would be well-placed to provide the management resource to replace the current Singapore management. It appears that other components necessary for the Main Divestment to operate as a standalone business are present.
117. In the scenario where the Main Divestment businesses are acquired by a third party, any purchaser would need to have a similar ability to manage USG Boral's Australasian operations. The Commission can ensure this is the case, as the Divestment Undertaking gives it the right to approve or reject a proposed purchaser.

Fall-back Divestment

118. There is a higher degree of uncertainty about the structure of the Fall-back Divestment
[

]
119. [
] ⁸⁰ In addition, the transitional supply arrangements in the ACCC Undertaking require that the Approved Purchaser is provided with any goods or services that are required for the Approved Purchaser to be established as a viable, effective, stand-alone, independent, and long-term competitor in the overlapping markets.⁸¹
120. Further, the Commission will be able to approve or reject any proposed purchaser of the Fall-back Divestment. We consider that this will allow us to ascertain whether a purchaser is likely to be able to compete as an independent supplier of modular suspended ceiling systems in New Zealand.
121. In combination, we consider that these factors minimise the risk that the Fall-back Divestment is too limited in scope to operate in competition with the merged entity.

Ability to obtain supply of modular suspended ceiling products

122. [
82
] We have considered the risk that the purchaser of the divested assets is not

⁸⁰ Divestment Undertaking at clause 7.9.

⁸¹ ACCC Undertaking at clauses 5.11-5.13.

⁸² []

able to secure adequate supply of modular suspended ceilings in the case of both the Main Divestment and the Fall-back Divestment.

Main Divestment

123. As noted, the ACCC Undertaking includes an agreement (to be approved by the ACCC) that ensures continued supply to the owner of the Main Divestment business [

]

124. Knauf submitted that this supply guarantee in the ACCC Undertaking provides assurance that the Main Divestment business will have adequate supply of modular suspended ceiling products.

125. As noted, the Commission is not able to accept behavioural undertakings to remedy competition concerns relating to a merger. In respect of the Commission's consideration of business mergers and acquisitions, section 69A of the Act provides:

(1) In giving a clearance or granting an authorisation under section 66 or section 67, the Commission may accept a written undertaking given by or on behalf of the person who gave a notice under section 66(1) or section 67(1), as the case may be, to dispose of assets or shares specified in the undertaking.

(2) The Commission shall not accept an undertaking in relation to the giving of a clearance or the granting of an authorisation under section 66 or section 67, other than an undertaking given under subsection (1).

126. As the Act specifies that in our consideration of a clearance application we may accept only structural undertakings, we are unable to accept an undertaking from Knauf that would ensure a purchaser has a guaranteed supply of modular suspended ceilings.

127. Nonetheless, Knauf submitted that the behavioural undertaking accepted by the ACCC forms part of the factual matrix before the Commission. It submitted that, as the ACCC will be able to enforce this undertaking, it should give the Commission comfort that the divested business will be supplied on terms favourable to the purchaser of that business.

128. In Knauf's view, the Supply Agreement gives purchasers a locked-in supply option in a competitive environment. It submitted that the terms offered will be competitive, not only because of the ACCC's direct oversight, but also because the Approved Purchaser would have alternative options for supply and could:

128.1 choose to switch to alternative suppliers (with the ACCC-approved supply terms locked in as a "fall-back" option during negotiations); or

128.2 []

129. The Supply Agreement does not specifically relate to New Zealand and the ACCC cannot insist on supply to the New Zealand divestment business. However, USG Boral’s New Zealand business is a wholly owned subsidiary of its Australian business and we understand that []. Because of this, enforcement of the Supply Agreement in Australia is likely to ensure access to supply for the New Zealand business.

130. Typically, it is desirable for a divestment to include a full suite of assets such that the divested business can replicate the pre-merger business as closely as possible. []

131. [83]

132. We consider that the existence of the Supply Agreement in the ACCC Undertaking will likely be sufficient to ensure stability of supply to the Main Divestment business in New Zealand [] following the sale of the Main Divestment business. After that period, it will be for the purchaser to renegotiate terms with Knauf and/or any new Knauf Boral joint venture⁸⁴, or otherwise find alternative sources of supply.

Fall-back Divestment

133. The ACCC Undertaking does not provide for a similar supply agreement in relation to the Fall-back Divestment. However, the ACCC Undertaking does provide an obligation for Knauf to ensure []⁸⁵ ⁸⁶]Therefore, we consider that the risk that the purchaser of the Fall-back Divestment will not have access to the supply of products needed to restore competition in New Zealand is reduced by this obligation.

⁸³ []

⁸⁴ Knauf and Boral have both suggested that, if only the Australasian businesses of USG Boral are divested, they intend to form a new joint venture in the current joint venture territory outside Australasia. See Boral’s media release of 25 February 2019, above n63.

⁸⁵ []

⁸⁶ []

134. This risk is further minimised by the provision in the Divestment Undertaking for the Commission to approve or reject a purchaser. The Commission is not likely to accept a purchaser of the Fall-back Divestment businesses where that purchaser would not have access to the necessary supply of products. In this way, the Commission would be able to ensure that any purchaser of the Fall-back Divestment businesses either has:
- 134.1 an adequate pre-existing supply of products; or
 - 134.2 sufficient arrangements in place for the purchaser to secure supply.
135. the Divestment Undertaking requires Knauf to []⁸⁷ If it does not do so, it breaches its undertakings to both the Commission and the ACCC. This provides a strong incentive for Knauf to ensure that the terms of sale for the Fall-back Divestment enable the purchaser to secure adequate product supply. In other words, if a proposed purchaser is not suitable because it does not have adequate product supply, Knauf will need to ensure that the purchaser is able to access adequate supply elsewhere if it is to get approval for the purchaser and avoid breaching the Divestment Undertaking.
136. We discuss the risk that a suitable purchaser will not be available in the section on purchaser risk, below.

Conclusion on composition risk

137. In summary, for both the Main Divestment and the Fall-back Divestment, we consider that the combination of the Divestment Undertaking and the assurance provided by the ACCC Undertaking sufficiently mitigate the risk that the divestment businesses would not have the necessary composition to operate independently and competitively post-divestment.

Purchaser risk

138. Typically, we consider the main purchaser risks to be that:
- 138.1 a purchaser acceptable to us may not be available; and/or
 - 138.2 the Applicant has an incentive to sell to a weak competitor for a low price rather than to a strong competitor.
139. In some cases, there may be little or no interest from potential purchasers. This might indicate that the divestment assets are unattractive to potential purchasers, which may cast doubt on the effectiveness of the undertaking.
140. An acceptable purchaser needs to have certain attributes that enable it to be an effective competitor in the relevant market, such as:

⁸⁷ Divestment Undertaking at Schedule 1, clause 1.

- 140.1 being independent of the merged entity;
 - 140.2 possessing or having access to the necessary expertise, experience, and resources to be an effective long-term competitor in the market; and
 - 140.3 not raising competition concerns in its acquisition of the divested shares or assets.
141. For both the Main Divestment and Fall-back Divestment, the Commission will be able to approve the purchaser. This will allow us to ensure that the purchaser is able to compete against the merged entity.
142. We have assessed whether a purchaser of the divestment assets is likely to be sufficiently independent of Knauf. In addition, we have considered whether a feasible purchaser is likely to be available.

Independence of the purchaser

143. []. In each case, we have considered whether a lack of independence for the Approved Purchaser creates a purchaser risk such that the Undertaking is unlikely to remedy our competition concerns.

Main Divestment

144. We do not consider that the potential supply links between Knauf and an Approved Purchaser are likely to undermine the effectiveness of the Main Divestment for the following reasons.
- 144.1 The Supply Agreement will prevent Knauf from undermining the competitive position of the Approved Purchaser by ensuring it is able to access supply of [] on competitive terms.
 - 144.2 The link is unlikely to increase the risk of coordinated effects. This is because, although the link between Knauf and the Approved Purchaser could provide Knauf with extra information on a competitor, this information would be asymmetric, limiting the ability for both competitors to monitor the outcomes of coordination. Further, it is unlikely that either party would have oversight of the prices charged by the other to their distributor/s, making it difficult to coordinate on price.

Fall-back Divestment

145. As noted, the ACCC Undertaking does not guarantee a supply agreement to the Approved Purchaser in the case of the Fall-back Divestment. Therefore, the independence of the Approved Purchaser does not have the potential protection that is offered by the Supply Agreement in the Main Divestment.
[

].

146. However, as discussed above, we consider that the Divestment Undertaking provides sufficient comfort that any Approved Purchaser will be able to secure independent supply of [], because:

146.1 the ACCC Undertaking provides that the Fall-back Divestment must include []; and

146.2 the Commission has the discretion to reject any proposed purchaser that would not have access to adequate supply of modular suspended ceiling systems on competitive terms. Knauf is incentivised to ensure that its proposed purchaser has adequate product supply to avoid breaching its undertakings.

147. In addition, the Commission's discretion to approve or reject any proposed purchaser of the Fall-back Divestment assets provides protection against the possibility of increased coordination resulting from the divestment. Specifically, the Commission can reject any purchaser it considers would result in increased risk of coordination.

148. As such, we consider that there are sufficient protections in place to ensure that any purchaser of either the Main Divestment business or the Fall-back Divestment business is sufficiently independent from Knauf.

Existence of a feasible purchaser

Main Divestment

149. The most likely purchaser of the Main Divestment business appears to be Boral, given that it already owns a 50% share in the business. We note that Boral has publicly referred to the possibility of acquiring the Australasian business of USG Boral in media releases⁸⁸ and [] Boral is a major multinational construction company with a market capitalisation of approximately AUD5.6 billion at the time of this determination.
[⁸⁹]

150. Knauf submitted that the Australasian business was historically wholly operated by Boral. As such, Boral has extensive knowledge of the Australasian business and remains the more engaged shareholder in relation to its operation.

⁸⁸ Boral Media Release, above n63.

⁸⁹ []

151. We note that, if Boral were to take 100% ownership of the Australasian business, it would likely remain in a joint venture with Knauf in other territories. However, Knauf and Boral would be independent entities in Australasia. As noted above, there appears to be little risk of increased coordination between Knauf and the Approved Purchaser based on the market conditions, and these conditions are likely to remain even with the existence of a joint venture in other jurisdictions.
152. Given the presence of Boral as a likely purchaser, we do not consider that there is a significant risk that there will not be a viable purchaser available for the Main Divestment Business.

Fall-back Divestment

153. Knauf noted that
[
] ⁹⁰ However, it submitted that at least two international industry participants may be interested in acquiring all or part of the Fall-back Divestment assets, namely China National Building Material Group Co. Ltd (BNBM) and Saint-Gobain Group. We note that both these entities are major international suppliers of building materials and products with broad manufacturing capabilities.

154. [

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155. As discussed, aside from the merging parties, there appears to be a lack of feasible alternative suppliers of modular suspended ceiling systems in New Zealand. While other suppliers with a significant global presence do exist, such as Rockfon, OWA, Daiken, and Saint-Gobain, there are barriers preventing those parties from expanding to compete with the merged entity in a timely fashion. The Fall-back Divestment offers [] that would allow a purchaser to overcome those barriers. This attractiveness is further enhanced by the fact that [].

156. Further, as noted above, Knauf has a strong incentive to ensure that a purchaser is able to access adequate supply if it is to get approval for the purchaser from the Commission and the ACCC and avoid breaching its undertakings.

157. For the above reasons, we do not consider that there is a significant risk that Knauf will not be able to find a viable purchaser for the Fall-back Divestment business.

⁹⁰ Knauf submission to Commerce Commission on remedy proposals (18 March 2019).

⁹¹ []

Conclusion on the Divestment Undertaking

158. We do not consider that the Divestment Undertaking presents a significant level of asset or composition risk. In our view there are sufficient safeguards in place to ensure that the assets will not deteriorate prior to divestment and that the makeup of the divestment business, including the supply agreement provided for in the undertaking accepted by the ACCC, is such that the purchaser is likely to be able to offer meaningful competition to the merged entity.
159. Further, we consider that the Divestment Undertaking presents a low level of purchaser risk. While there is no upfront buyer, we have identified a potential purchaser of the Main Divestment business that is likely to be suitably experienced in order to restore competition to the relevant markets. In the event that this party does not acquire the divested assets, we reserve the right to approve or reject any other purchaser.

Overall conclusion

160. We are satisfied that the Proposed Merger, together with the Divestment Undertaking, will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

Determination on Notice of Clearance

161. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to Gebr. Knauf KG and USG Corporation to merge their businesses subject to the divestment undertaking dated 3 April 2019 provided by Gebr. Knauf KG under section 69A of the Commerce Act 1986.

Dated this 18th day of April 2019

Anna Rawlings
Chairperson

- 7.2 **Completion Date** means the date on which the Transaction becomes unconditional;
- 7.3 **days** means working days as defined in the Interpretation Act 1999;
- 7.4 **Divestment** means completion of transactions that entail the unreserved divestment to an Approved Purchaser or Purchasers of:
 - (a) the Divestment Business; or, if this does not occur within the Initial Sale Period,
 - (b) the Fall-back Divestment Business;
- 7.5 [].
- 7.6 **Divestment Business** means Knauf’s entire interest (whether direct or indirect) in USG Boral Building Products Pty Limited¹ and its subsidiary, USG Boral Building Products NZ,² including all intellectual property rights, assets and contracts;
- 7.7 **Divestment Manager** means the person appointed pursuant to clause 11.1;
- 7.8 **Divestment Period** means the Initial Sale Period plus Fall-back Divestment Period;
- 7.9 **Fall-back Divestment Business** means[

3

4]
- 7.10 **Fall-back Divestment Manager** means the person appointed in accordance with clause 11.2;
- 7.11 **Fall-back Sale Period** means [] from the day after the end of the Initial Sale Period;
- 7.12 **Initial Sale Period** means [] from the Commencement Date;
- 7.13 **Relevant Divestment Business** means either the Divestment Business or the Fall-back Divestment Business as the context requires;
- 7.14 **Relevant Divestment Manager** means either the Divestment Manager in respect of the Divestment Business or the Fall-back Divestment Manager in respect of the Fall-back Divestment Business;

¹ Incorporated in Australia.
² Incorporated in New Zealand.
³ []
⁴ []

- 7.15 **Relevant Period** means either the Initial Sale Period in respect of the Divestment Business or the Fall-back Sale Period in respect of the Fall-back Divestment Business;
- 7.16 **Shareholders Agreement** means the 28 February 2014 agreement that establishes the USG Boral JV;
- 7.17 **USG Boral JV** means the joint venture between USG Netherlands Global Holdings B.V., Boral International Pty Limited and Boral Building Materials Pty Limited, which owns USG Boral Building Products Pty Limited.

Conduct during the Divestment Period

Preservation obligations

- 8 Knauf will, during the Divestment Period, use all reasonable endeavours to:
- 8.1 preserve the reputation and goodwill of the Divestment Business and the Fall-back Divestment Business;
- 8.2 preserve the economic viability, marketability and competitiveness of the Divestment Business and the Fall-back Divestment Business, including maintaining appropriate levels of staff; and
- 8.3 maintain the Divestment Business' and the Fall-back Divestment Business' provision of goods and services in a manner consistent with the provision of goods and services as at the date of the Undertaking, including continuing to operate the Fall-back Divestment Business in competition with the Divestment Business.
- 9 Except as set out at paragraph 8.3, Knauf will not:
- 9.1 carry out any act upon its own authority that might have a significant adverse impact on the value, management or competitiveness of the Divestment Business or Fall-back Divestment Business, or that might alter the nature and scope of activity, or the industrial or commercial strategy, of the Divestment Business or Fall-back Divestment Business; or
- 9.2 sell or transfer the Divestment Business or Fall-back Divestment Business, or any assets or substantial part of the Divestment Business or Fall-back Divestment Business, to any person other than an Approved Purchaser.
- 10 The obligations at clauses 8 and 9 above cease to apply in relation to the Divestment Business at the end of the Initial Sale Period.

Hold-separate obligations

- 11 Knauf will appoint:
- 11.1 a Divestment Manager who will operate the Divestment Business from the Completion Date until either:
- (a) the sale of the Divestment Business to an Approved Purchaser; or
- (b) the end of the Initial Sale Period; and

- 11.2 a Fall-back Divestment Manager who will operate the Fall-back Divestment Business from the end of the Initial Sale Period until the sale of the Fall-back Divestment Business to an Approved Purchaser.⁵
- 12 In each case, Knauf will procure that during the Relevant Period the Relevant Divestment Manager will conduct the Relevant Divestment Business:
- 12.1 as a fully operational, competitive going concern;
- 12.2 separate from the rest of Knauf's business,
- in such a way that preserves the economic viability, marketability, competitiveness and goodwill of the Relevant Divestment Business.
- 13 During the Relevant Period in the case of each Relevant Divestment Business:
- 13.1 the Relevant Divestment Manager will have the sole capacity to make all decisions in relation to the Relevant Divestment Business and will not consult, seek direction from, or follow directions from Knauf other than in accordance with the terms of its appointment and this Undertaking;
- 13.2 Knauf will not be involved in the management or "business as usual" operation of the Relevant Divestment Business;
- 13.3 all employees involved with the Relevant Divestment Business will report to the Relevant Divestment Manager in relation to their Relevant Divestment Business;
- 13.4 Knauf and the Relevant Divestment Business will operate separate trade pricing and accounting systems which are password protected;
- 13.5 no Knauf employee will have access rights to the Relevant Divestment Business' systems except as approved by the Commission in writing, in which case the employee(s) will be required to sign confidentiality undertakings before access rights are granted; and
- 13.6 no Knauf employee will have access to emails of employees involved in the Relevant Divestment Business.
- 14 During the Initial Sale Period Knauf will:
- 14.1 take no steps to interfere in the provision of working capital and sources of credit in respect of the USG shareholding in the USG Boral JV;
- 14.2 continue to facilitate the provision of working capital and sources of credit in respect of the USG shareholding in the USG Boral JV which is consistent with the financing obligations contained in the Shareholders Agreement; and
- 14.3 take no steps to interfere with USG's continued administrative and technical support to the Divestment Business.

⁵ Assuming one is required, i.e. that the Divestment Business has not been sold during the Initial Sale Period.

- 15 The Fall-back Divestment Manager will cooperate with [] to facilitate the successful divestment of the Fall-back Divestment Business in accordance with this Undertaking and taking into account [] as set out in Schedule 1.

Appointment of the Divestment Manager

- 16 [], Knauf will obtain the Commission's approval in writing of the identity of the Divestment Manager and the terms of appointment.

Appointment of the Fall-back Divestment Manager

- 17 [] Knauf will provide the Commission with the proposed identity of, and terms of appointment for, the Fall-back Divestment Manager. The Commission shall have the discretion to approve or reject in writing the proposed Fall-back Divestment Manager.

- 18 []

18.1

18.2

]

Ring-fencing obligations

- 19 During the Initial Sale Period the Divestment Manager, and during the Fall-back Sale Period the Fall-back Divestment Manager [], will ensure that systems are in place (and will monitor the effectiveness of those systems during the Relevant Period) to prevent commercially sensitive information regarding the Relevant Divestment Business being provided to Knauf other than in accordance with clause 21 and for the purposes of Knauf:
- 19.1 selling the Relevant Divestment Business to an Approved Purchaser (but subject to clause 22);
- 19.2 reporting to the Commission as required by clauses 31 and 32; and
- 19.3 complying with its legal and regulatory obligations (including obligations related to taxation, accounting, financial reporting or stock exchange disclosure requirements).
- 20 Knauf will procure that all members of its staff (including independent contractors) and those of its affiliates who might receive any commercially sensitive information in relation to the Relevant Divestment Business during the Relevant Period sign a confidentiality undertaking pursuant to which they undertake not to access or use such information except for the purposes set out in clause 19 and/or 22.
- 21 Commercially sensitive information regarding the Relevant Divestment Business which is provided to Knauf by the Relevant Divestment Manager [] for the purposes set out in clause 19 will be disclosed only to those officers, employees,

contractors, agents and advisers of Knauf who need to know the information in order to carry out those purposes, and who have signed a confidentiality undertaking.

Role of the Relevant Divestment Manager in the sale process

- 22 The Relevant Divestment Manager will be responsible for protecting the confidential information of the Relevant Divestment Business during the sale process, including:
- 22.1 execution of confidentiality agreements with potential interested parties;
 - 22.2 consideration of commercially sensitive information and, where relevant during due diligence, either redacting or withholding the information from potential interested parties;
 - 22.3 provision of due diligence information, questions and answers, and requests for further information;
 - 22.4 limiting access to any data room only to interested parties and their representatives who, in the reasonable opinion of [], have a realistic prospect of becoming the Approved Purchaser in due course;
 - 22.5 limiting access to any data room to nominated members of Knauf's in-house legal team as approved by the General Counsel of Knauf and/or Knauf's advisers; and
 - 22.6 subject to clause 20, providing to [] information that is requested for the purpose of giving effect to the sale process.

Non-solicitation obligations

- 23 Knauf undertakes that, subject to legal limitations, it will not solicit any staff of the:
- 23.1 Divestment Business during the Initial Sale Period; or
 - 23.2 Fall-back Divestment Business during the Fall-back Sale Period.

All reasonable endeavours

- 24 Knauf will use all reasonable endeavours to procure, obtain, or assist any Approved Purchaser in obtaining any consents necessary for the transfer or assignment of relevant contracts to the Approved Purchaser.
- 25 The relevant contracts referred to in clause 24 above include:
- 25.1 any contracts to which the Relevant Divestment Business is a party;
 - 25.2 any contracts to which Knauf (including its interconnected or associated bodies corporate) is a party that are reasonably required for the business as usual operation of the Relevant Divestment Business;
 - 25.3 in relation to the Divestment Business, any contracts to which the USG Boral JV (including its interconnected or associated bodies corporate) is a party that are

reasonably required for the business as usual operation of the Divestment Business; and

25.4 for the avoidance of doubt, leases and licences.

Purchaser approval

- 26 [] will notify the Commission [] before the end of the Initial Sale Period of the identity of any proposed purchaser of the Divestment Business.
- 27 [] will notify the Commission [] before the end of the Fall-back Sale Period of the identity of any proposed purchasers of the Fall-back Divestment Business.
- 28 [], must demonstrate to the Commission that the Divestment will be carried out in a manner consistent with the Undertaking and that the proposed purchaser:
- 28.1 will be independent of Knauf and USG, and any of their interconnected or associated bodies corporate;
- 28.2 has the financial resources, expertise and incentive to operate the Divestment Business or the Fall-back Divestment Business as a viable competitor including, at the Commission's request, procuring that the proposed purchaser provide financial statements to the Commission to evidence this point; and
- 28.3 is not likely to create competition concerns that would result in a contravention of section 47(1) of the Commerce Act 1986.
- 29 The Commission shall have the discretion to approve or reject in writing any purchaser proposed by [].
- 30 The Commission's approval of any purchaser proposed by [] shall also be contingent on:
- 30.1 [], providing all transaction documentation proposed to effect the Divestment (including any sale and purchase, transitional and other ancillary agreements) to the Commission at least [] they are executed; and
- 30.2 the Commission's approval in writing of that transaction documentation.
- Monitoring compliance with the Undertaking**
- 31 Knauf, the Relevant Divestment Manager [] will, at the Commission's request, provide to the Commission any information and documents reasonably required and within such time as the Commission may specify:
- 31.1 about the Divestment and [] progress towards carrying out the Divestment; and
- 31.2 demonstrating that Knauf's conduct during the Divestment Period complies with the Undertaking.

- 32 Without limiting clause 31, Knauf undertakes to:
- 32.1 procure that during the Initial Sale Period the Divestment Manager submit a monthly report to the Commission providing updates on the performance of the Divestment Business and implementation of the hold-separate arrangements;
 - 32.2 procure that during the Fall-back Divestment Period the Fall-back Divestment Manager submit a monthly report to the Commission providing updates on the performance of the Fall-back Divestment Business and implementation of the hold-separate arrangements;
 - 32.3 [];
 - 32.4 provide the Commission with a copy of all transaction documents effecting the Divestment within [] execution; and
 - 32.5 notify the Commission of the Divestment within:
 - (a) [] of completion of Divestment of the Divestment Business; or
 - (b) [] of completion of Divestment of the Fall-back Divestment Business.
- 33 Nothing in this Undertaking requires Knauf to provide legally privileged information or documents.

Executed as a deed on behalf of **Gebr. Knauf KG**

Signature of Authorised Representative

Print Name and Title

SCHEDULE 1: DIVESTMENT OF THE FALL-BACK DIVESTMENT BUSINESS

[

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