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COMMERCE COMMISSION

Decision No. 531

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

GALLAGHER HOLDINGS LIMITED

and

TRU-TEST CORPORATION LIMITED

The Commission:	Paula Rebstock Denese Bates Peter JM Taylor
Summary of Application:	The acquisition by Gallagher Holdings Limited of all the ordinary shares of Tru-Test Corporation Limited including the proposed divestment of the PEL brand.
Determination:	Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline to give clearance to the proposed acquisition.
Date of Determination:	26th August 2004

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EXECUTIVE SUMMARY

The Proposal

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 19th May 2004. The notice sought clearance for the acquisition by Gallagher Group Holdings Limited of up to 100% of the ordinary shares of Tru-Test Corporation Limited. This proposal was amended on 20 July 2004 to include a divestment undertaking.

Market Definition

2. The Commission concludes that the relevant markets for this acquisition are as follows:
   - the national market for the manufacture and wholesale supply of rural and security electric fencing products (the electric fencing market);
   - the national market for the manufacture and wholesale supply of rural conventional wire fencing products (the conventional wire fencing market);
   - the national market for the manufacture and wholesale supply of rural fence posts (the fence posts market);
   - the North Island market for the manufacture and wholesale supply of rural gates and gate hardware (the North Island gates market);
   - the South Island market for the manufacture and wholesale supply of rural gates and gate hardware (the South Island gates market); and
   - the national market for the manufacture and wholesale supply of animal weighing systems and accessories (the animal weighing systems market).

Factual

3. In the factual, the PEL brand is assumed to be divested to one of the existing competitors, or a new entrant, and operate as a separate competitor to the combined entity in the electric fencing market. Post acquisition the combined entity would be by far the largest supplier of rural electric fencing products, and the only supplier of security electric fencing products in New Zealand. The combined entity would also operate in a number of other agricultural markets including, conventional wire fencing products, gates and gate hardware, posts and animal weighing systems.
4. The Commission also notes that [ ] of PEL, it would be possible for the Commission to not give any weight in its competition analysis to the PEL divestment. However, the Commission will, for completeness, assume the factual includes the successful divestment of PEL. The Commission notes that if there is a substantial lessening of competition with PEL as a viable divestment, a substantial lessening of competition would also eventuate if PEL was not a viable divestment.

Counterfactual

5. The Commission is of the view that the appropriate counterfactual is the status quo as Tru-Test is unlikely to be sold and would, but for the acquisition, remain a strong competitor.

Competition Analysis

6. The Commission is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of a substantial lessening of competition in the fence posts market, the conventional wire fencing market, the North Island gates market, the South Island gates, and the animal weighing systems market due to the constraint on the combined entity that would be imposed by existing competition.

Electric Fencing Market

7. In the case of the electric fencing market, the loss of existing competition between Gallagher and Tru-Test as a result of the proposed acquisition is considered to be very significant, particularly as there is currently a strong competitive tension between Gallagher and Tru-Test. This very significant loss of existing competition evident in the counterfactual is unlikely to be restored by fringe competitors in the factual within two years of the acquisition.

8. In the case of the electric security segment of the market, there would be a 100% aggregation in market share and it is likely that there would be a substantial lessening of competition in this segment under the factual. Further, this segment is unlikely to provide any significant competitive constraints on the rural segment within two years of the acquisition.

9. While the Commission notes that the divestment of PEL reduces the combined entity's market share in respect of rural electric fencing products from [ ]% to [ ]%, the proposed acquisition nevertheless still results in a very significant loss of existing competition. PEL's segment share is [ ] further undermines its ability to act as an effective constraint on the combined entity post acquisition. In the counterfactual, Gallagher and Tru-Test would remain two equally matched competitors that would continue to fiercely compete in terms of price and innovation. The divestment of PEL would be unlikely to restore such fierce existing competition in the factual within two years.

10. The Commission has found a number of high barriers to entry and/or expansion within a two year timeframe, namely:

    - access to resellers;
    - brand and reputation;
    - infrastructure;
    - the sunk costs (arising from developing manufacturing capabilities in New Zealand), the potential lack of critical mass, intellectual property, and the need to develop a complete product range;
    - bundling;
    - volume-based rebates; and
    - strategic barriers or incumbent response.

11. Due to the height of these barriers, it appears that while expansion from small competitors such as [ ] may be likely, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years.

12. The Commission considers that overseas suppliers such as [ ] would be unlikely entrants and are therefore unlikely, via either security or rural electric fencing products, to prevent the combined entity from raising its prices or reducing the quality of product and service it currently provides.

13. The Commission considers that PEL would be likely to face high barriers to expansion in the electric fencing market. Notably, PEL faces:

    - limited short to medium term access to the large rural resellers;
    - restoring brand and reputation;
    - hight capital costs and a two year plus timeframe to develop and upgrade PEL's range of energisers;
    - [ ];
    - volume-based rebates;
    - bundling; and
    - vigorous incumbent response.

14. The Commission considers that a potential acquirer of PEL, provided it had sufficient funds, could improve its access to resellers by upgrading its product range by investing in research and development. However, the research and development needed to offer a sufficiently competitive alternative to that of the combined entity would be likely to take over two years to complete; would be conducted in the face of limited access to resellers; incumbent response; and would require significant funding.

15. Accordingly, it appears expansion by PEL is likely to be limited at best. In the event that expansion did occur, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years, and would not result in the restoration of the competitive levels evident in the counterfactual.

16. Given the limited extent of any likely entry or expansion, the large rural resellers and security electric fencing customers would have limited ability to exercise countervailing power under the factual (in comparison with the counterfactual) to prevent the combined entity from raising prices or reducing the quality of product and service supplied.

17. Overall, the Commission considers that the difference between the factual and the counterfactual is that two equally matched competitors driving fierce competition would no longer exist in the factual and fringe players in the counterfactual would remain fringe players in the factual and would be insufficient to constrain the combined entity. Similarly, the divestment of PEL is considered unlikely to restore fierce existing competition in the factual.

18. Table 1 illustrates this comparison of the counterfactual with the factual.

Table 1: Comparison between Counterfactual and Factual

	Counterfactual	Factual
Existing Competition	Fierce competition between two evenly matched firms, Gallagher and Tru-Test.	Fierce existing competition between Gallagher and Tru-Test is lost and is unlikely to be restored by fringe competitors or PEL.
Barriers to Entry and Expansion	High	Remain high
Existing Competitor's Expansion	Limited - would take over two years and would face high barriers to becoming a competitive alternative.	Possible expansion by fringe competitors or PEL would face high barriers and would be unlikely to restore fierce competition evident in the counterfactual.
Potential Overseas Competition	None – due to small size of NZ market, freight costs and the cost of developing high joule energisers.	None – due to reasons in counterfactual and the added risk of incumbent response.
Countervailing Power	High as large resellers have strong competitive alternatives.	Significantly weakened with loss of competition between two fierce competitors.

19. Taking into account all the relevant issues, the Commission concludes that the acquisition would be likely to lead to a substantial lessening of competition in the manufacture and supply of electric fencing products.

Overall Conclusion

20. Due to sufficient existing competition or potential competition, the proposed acquisition is considered to be unlikely to lead to a substantial lessening of competition in the following markets:

    - the conventional wire fencing market;
    - the fence posts market;
    - the North Island gates market;
    - the South Island gates market; and
    - the animal weighing systems market.

21. The Commission considers that the acquisition would be likely to lead to a substantial lessening of competition in the electric fencing market due to the significant loss of existing competition, high barriers to expansion and entry, the limited extent of any expansion by small existing competitors or new entrants, and the limited countervailing power of rural resellers. Such a substantial lessening of competition is considered likely with or without the divestment of the PEL brand.

22. Accordingly, pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline to give Clearance for the proposal that Gallagher Group Holdings Limited acquire up to 100% of the ordinary shares of Tru-Test Corporation Limited as amended by the divestment undertaking of 20 July 2004.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 19 May 2004. The notice sought clearance for the acquisition by Gallagher Group Holdings Limited (Gallagher) of up to 100% of the ordinary shares of Tru-Test Corporation Limited (Tru-Test).

2. On 20 July 2004, the Commission received an amendment to the Application which states that Gallagher would undertake to divest the PEL brand of electric fencing post acquisition.

PROCEDURE

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear a notice given under s 66(1) within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 26th August 2004.

4. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

5. The Commission's approach to analysing this proposed acquisition is based on principles set out in the Commission's *Merger and Acquisition Guidelines.*

STATUTORY FRAMEWORK

6. Under s 66 of the Act, the Commission is required to grant clearance to an Application, made in accordance with s 66(1) of the Act, for an acquisition where it is satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[1]

7. The Commission considers that in determining this Application it is necessary to identify whether there is likely to be a real lessening of competition that is not minimal.[2] For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both real or of substance, and able to be sustained for a period of at least two years.

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[1] *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

[2] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758; Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced service, quality or innovation, for there to be a substantial lessening, or likely substantial lessening, of competition, these also have to be both real or of substance, and sustainable for at least two years.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
    - with the acquisition in question (the factual); and
    - in the absence of the acquisition (the counterfactual).
11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:
    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Gallagher

12. Gallagher is a privately owned company based in Hamilton, New Zealand. Gallagher manufactures and supplies animal and security management systems in New Zealand and to over 100 countries around the world. In the Application, Gallagher lists its key products as:
    - rural and security electric fencing products;
    - animal weighing systems;
    - contract manufacturing;[3]
    - security access control products; and
    - fuel dispensing products.
13. Gallagher manufactures and supplies gates and gate hardware through its fully owned subsidiary Franklin Machinery Limited (Franklin).

[3] The Commission notes that both Gallagher and Tru-Test offer contract manufacturing services. Gallagher engages in plastics contract manufacturing, while Tru-Test engages in electronics assembly. As the parties engage in different contract manufacturing sectors, there is likely to be no change in the factual. Accordingly, the Commission did not consider the competition effects on contract manufacturing services any further.

14. Gallagher has been operating in New Zealand since the 1930s, and employs [ ] staff in New Zealand. Gallagher's total group revenue for the year ended 30 June 2003 was $[ ], of which [ ]% is derived from exports.

Tru-Test

15. Tru-Test is a public unlisted company whose 200 shareholders include its management [ ] and a range of family trusts and private investors. Gallagher recently acquired [ ]% of Tru-Test's shares. Like Gallagher, Tru-Test manufactures and supplies animal and security management systems in New Zealand and to over 70 countries worldwide. Tru-Test lists its key products as:

- rural electric fencing (under the Stafix, PEL, and Speedrite brands) and security electric fencing;
- conventional fencing (under the "Cyclone" brand);
- animal weighing systems;
- contract manufacturing;[4]
- milk metering equipment;
- shearing products; and
- brain monitoring equipment.

16. Tru-Test has been trading in New Zealand in its current form since 1963, and its group revenue for the year ended 31 August 2003 was $[ ].

OTHER RELEVANT PARTIES

Electric Fencing Competitors

O'Brien Plastics (O'Brien)

17. O'Brien is based in Auckland and was established in 1979. O'Brien manufactures and supplies a range of engineering plastic products, and contract manufactured products. Of particular relevance to this Application is O'Brien's manufacture and supply of a limited range of plastic electric fencing accessories including, reels and insulators, as well as a recently developed low joule battery energiser which are to be sold through rural resellers.

18. O'Brien is owned by HPM Industries Pty ("HPM") which is one of the largest manufacturers and suppliers of electrical accessories in Australasia.

Taragate Limited (Taragate)

19. Taragate is a privately-owned Hamilton-based company that was established in 1994. Taragate supplies a niche range of electrified gates and electric fencing accessories such as insulators to rural resellers throughout New Zealand. Taragate employs [ ] staff and its revenue for 2003 was $[ ].

Robertson Engineering Limited (Robertson)

20. Robertson is a privately-owned Wellington-based manufacturing company that was established in 1972. Its three key product categories are manufacturing and supplying blades for agricultural machinery, manufacturing and supplying meat hooks, and manufacturing and supplying fencing accessories for both

[4] Ibid.

conventional permanent wire fencing and electric fencing under the "Strainrite" brand. It employs [ ] staff and has annual revenue of approximately $[ ].

Artex Limited (Artex)

21. Artex is a privately-owned Waipukurau-based distribution company that was established in 1994. Artex imports and distributes ethical pharmaceuticals and water filters. Artex also imports and distributes the "Red Snap'r" brand of electric fencing products which it sources from Zareba in the United States. Artex's annual revenue from the distribution of its Red Snap'r electric fencing products amounts to $[ ] annually.

Hurricane Wire Products Limited (Hurricane)

22. Hurricane is a wholly-owned subsidiary of Steel & Tube Holdings Limited (Steel & Tube). Steel & Tube acquired the assets of Hurricane in mid-2003. Hurricane is New Zealand's [ ] producer of wire products, with manufacturing operations in Auckland and Christchurch.

23. Hurricane's primary business is the production and distribution of conventional wire fencing systems and other wire applications. Hurricane's product range includes reinforcing mesh, nails, farm fencing and farm gates. Hurricane also manufactures and distributes building, construction and security products.

24. Hurricane distributes Gallagher branded electric fencing products through a sales and marketing arrangement with Gallagher.

Steel & Tube

25. Steel & Tube (Hurricane's parent company) is a publicly-listed company on the New Zealand Stock Exchange (NZX), and is the parent company of a number of subsidiaries involved in the merchandising, processing and manufacture of a range of steel products.

26. Steel & Tube has a total of 54 business units and service centres servicing the construction, rural, and manufacturing sectors throughout New Zealand.

Overseas Electric Fencing Companies

Daken Australia Pty Limited (Daken)

27. Daken is a wholly-owned subsidiary of Clark Equipment Pty Limited, which is a privately-owned Australian company. Daken manufactures and supplies tractor implements throughout Australasia, and electric fencing products throughout Australia. Of relevance to this Application is Daken's electric fence operations, which account for AUS$[ ] of Daken's annual revenue. Daken offers a range of electric fencing products including a range of energisers.

Thunderbird Australia Pty Limited (Thunderbird)

28. Thunderbird was established in its current form in 1983, and is a privately-owned Australian-based company that manufactures and supplies a range of rural electric fencing products and animal weighing systems. Thunderbird employs [ ] staff and supplies its products throughout Australia except the West Coast. Thunderbird estimates that it has approximately [ ]% market share of the electric fencing market in Australia.

Zareba Systems (Zareba)

29. Zareba is a wholly-owned division of Waters Instruments Inc., which describes itself as a provider of value-added technology solutions. Zareba is the largest North American-based manufacturer and supplier of a full range of electric fencing products. Zareba's revenue for 2003 was estimated to US$[ ], and it estimates that it has approximately a [ ]% market share in the United States. Zareba exports a small amount of its products to Artex in New Zealand under the Red Snap'r brand.

Rutland Electric Fencing Co Limited (Rutland)

30. Rutland was established in 1973, and is a privately-owned United Kingdom based company that manufactures and supplies a full range of rural electric fencing products and security electric fencing products. Rutland is the largest manufacturer of electric fencing products in the United Kingdom and also exports to a number of countries, particularly the United States.

Horizont Agar Germany (Horizont)

31. Horizont was established in the mid-1950s, and is a privately-owned German-based company that manufactures and supplies a full range of electric fencing products. Horizont is one of the largest manufacturers of electric fencing products in Europe.

Gates Competitors

Greyson Gates Limited (Greyson)

32. Greyson is a wholly-owned subsidiary of Perry Group Limited (Perry). Perry acquired Greyson in 2002. Greyson supplies gates and gate hardware to rural resellers in New Zealand. Greyson has [

].

Walker Industries (NZ) Limited (Walker Ltd)

33. Walker Ltd is a privately-owned Christchurch-based company that was established in 1984. Walker Ltd manufactures and supplies gate hardware, and produces a small quantity of gates to building supply stores and independent rural resellers throughout New Zealand. Walker Ltd's annual revenue for 2003 was approximately $[ ].

Animal Weighing Systems Competitors

Iconix New Zealand Limited (Iconix)

34. Iconix is a privately-owned Oamaru-based company that was established in 1990. Iconix manufactures and supplies animal weighing systems to agricultural manufacturers, such as automatic drenching manufacturers, and rural resellers. Iconix employs [ ] staff and its annual domestic revenue for 2003 was approximately $[ ].

Industrial Weighing Competitors

35. The three largest industrial weighing equipment companies in New Zealand are:

- Wedderburn Scales Limited (Wedderburn);
- Sensortronic Scale Industries (NZ) Limited (Sensortronic); and

- Atrax Group New Zealand Limited (Atrax).

Rural Resellers

36. A high proportion of agricultural products are sold to customers/farmers through rural resellers. Of particular relevance to this Application is the fact that 85% of electric fencing products are sold through eight large rural resellers:[5]

    - RD1.com Limited (RD1);[6]
    - Wrightson Limited (Wrightson);
    - Farmlands Trading Society Limited (Farmlands);
    - CRT Society Limited (CRT);
    - Pyne Gould Guinness Limited (PGG);
    - Goldpine Group Limited (Goldpine);
    - Williams & Kettle Limited (Williams & Kettle); and
    - Allied Farmers Limited (Allied Farmers).

37. The remaining 15% of agricultural products are sold through a mixture of small independent rural resellers and building supply stores.

PREVIOUS DECISIONS

38. The Commission has previously considered the conventional permanent wire fencing and electric fencing industries in the course of three Commission investigations:[7]

    - Tru-Test Ltd / Stafix Electric Fencing Limited, 27 May 1998 (BAE: 686 J2871);
    - Tru-Test / PEL, 14 August 2001 (J4561); and
    - Steel & Tube Holdings Limited / Hurricane Wire Products Limited, 23 June 2003 (295213-1, J5800).

39. On 15 May 1998, Tru-Test acquired Stafix Electric Fencing Limited (Stafix). The Commission investigated this acquisition. Tru-Test submitted that electric fencing fell within a broader category of fencing that included electric fencing and permanent conventional wire fencing. At the same time, Gallagher advised the Commission that electric fencing was a separate market.

40. The Commission identified the market as being that for the manufacture and distribution of electric fencing systems and considered that if there were no issues in the narrow market then there would be no issues in broad market and

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[5] The fact that approximately 85% of electric fencing products are sold through the eight largest rural resellers was confirmed by the resellers themselves and a number of other industry participants.
[6] RD1 is a wholly-owned subsidiary of Fonterra Co-operative Group Limited.
[7] The Commerce Act ("the Act") provides for a voluntary notification regime for proposed acquisitions, under which parties contemplating an acquisition may submit an application for clearance or authorisation if they are in doubt as to whether their proposed acquisition might contravene s 47. If parties choose to proceed with an acquisition without seeking prior clearance or authorisation, the Commission may initiate an investigation under s 47 of the Act.

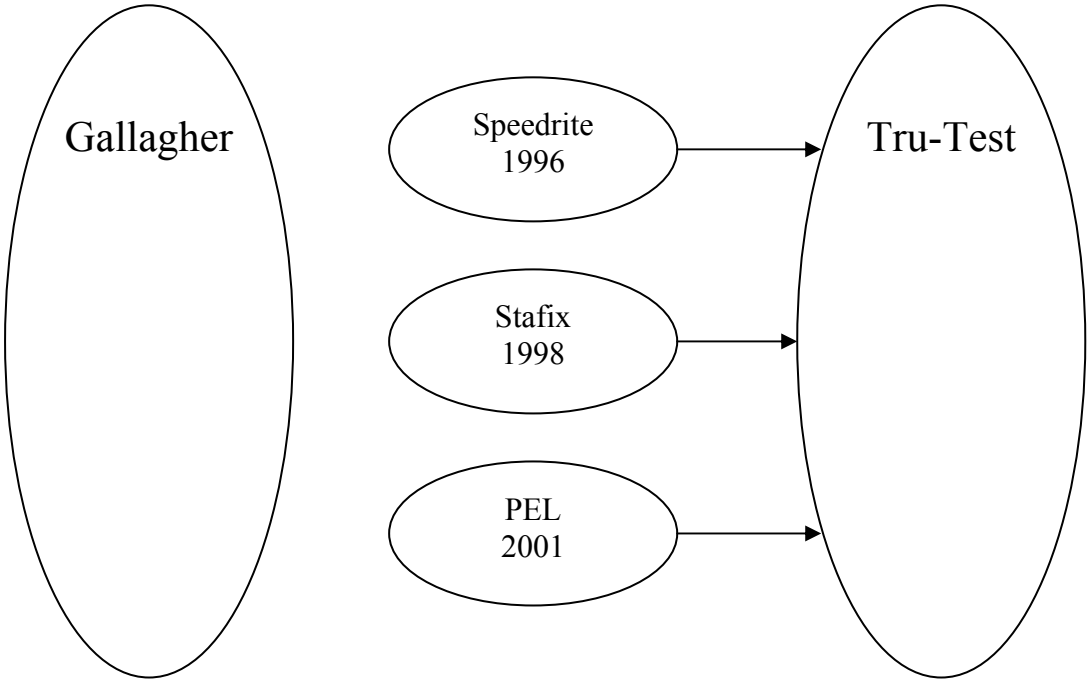
concluded that existing competition from Gallagher and PEL was sufficient to constrain the combined entity.

41. In August 2001, Tru-Test acquired PEL Industries Limited (PEL). The Commission investigated the acquisition adopting the same market definition employed in the Stafix investigation and again concluded that if there were no issues in the narrow market then there would be no issues in the broad market. The Commission considered that Gallagher provided sufficient constraint on the combined entity noting that de novo entry was unlikely due to the capital cost of developing a product and a brand.

42. In April 2003, Steel & Tube Holdings Limited purchased the assets of Hurricane. The acquisition raised potential issues of vertical integration for special wires. The Commission investigated the acquisition and defined a number of markets including a national market for the production and distribution of fencing products, considering that competition issues could be best analysed under this broad market definition. The Commission, noted that there could be a separate market for electric fencing, but did not need to discuss this further.

43. Diagram 1 below summarises the recent structural changes in the electric fencing industry.

Diagram 1: History of Tru-Test Acquisitions



INDUSTRY BACKGROUND

44. There are a variety of ways in which a rural property can be fenced. The fencing option chosen depends on a number of factors including: the size of the property; the type of animals being contained; and personal preference.

45. The two basic methods of fencing a rural property are discussed below.

Electric Fencing

46. Every electric fence has the following basic components:

- A wire or filament carries an electric charge along the fence-line. This is the "hot," above-ground part of the system.
- An energiser pushes power through the fence. To meet safety standards, most systems deliver power in a series of pulses, usually about one per second. That time between pulses helps the animal to break free of the fence. (A continuous current might cause the animal to "lock on" unable to let go.)
- A ground system, usually a series of metal rods sunk into the earth and connected to the energiser via a ground wire, waits dormant until the fence is touched by any animal that is also in contact with the ground. The ground system attracts the charge through the animal which completes the circuit and returns the current to the energiser.

47. Electric fencing systems operate on a very simple principle: electricity will only travel through a closed circuit. The fence wire, energiser and ground rods are three parts of a circuit waiting to be closed; when an animal touches the wire, it closes the gap, and assuming nothing blocks or impedes the flow of electricity, a surge of current will travel through the animal from the fence to the rods planted in the ground. Once the circuit is complete, the animal will feel a shock that is likely to discourage it from touching the fence again. With an electric fence, the goal is to sting or startle the animal without causing harm, so electric fences operate with low amperage and higher voltage.

48. Animals are the intended targets of electric fences, but anything else that comes in contact with both fence and ground will also complete the circuit. Very small items, such as blades of grass, allow a small amount of power to travel from the fence to the ground rods, but not enough to drain the entire system. A short circuit occurs when an object, such as a fallen tree limb, reroutes all of the power from the fence to the ground system. Beyond the tree limb, the charge left in the fence is reduced to zero.

49. An electric fencing system is generally made up of a number of components: The main components of a basic electric fencing system are:

- Energisers (mains or battery powered);
- Electric fence strainers;
- Posts; and
- Electric fence accessories including fence wire, tape, insulators, under gate cables, reels and accessories.

50. The Commission has been advised by a number of parties within the industry that approximately [ ]% of sales for electric fencing are for parts to replace the various components of an existing electric fencing system. The remaining [ ]% of sales represent complete electric fencing systems, predominantly used for dairy farm conversions in recent years.

51. In New Zealand, electric fences are used on most types of rural properties from lifestyle blocks to large commercial farms. Electric fences are predominately used by beef and dairy farmers as it is a functionally advantageous and cost

effective method of managing livestock, especially bulls. In contrast, sheep farmers tend to use conventional permanent wire fencing as sheep are "well insulated" meaning electric fences may be less effective. As such, conventional wire fencing (including prefabricated netting) is used by many sheep farmers in preference to permanent electric fencing (although some sheep farmers – particularly in the North Island – do use temporary and semi-permanent electric fencing).

52. Electric fencing is often a preferred method of subdividing large farms as it is suited to a particular application for containing livestock, for example, strip grazing. It also represents a lower capital outlay than that of conventional permanent wire fencing. However, due to short circuits, an electric fencing system requires more on-going maintenance compared to a conventional permanent wire fencing system.

53. An electric fencing system can be separated into three categories: permanent; semi-permanent; and temporary.

Permanent Electric Fencing

54. Permanent electric fences are generally made up of up to three electrified high-tensile wires connected to permanent round-wood or steel posts. These fences typically use mains-powered high power energisers and are generally favoured by larger commercial beef and dairy farms to create permanent subdivisions within large paddocks.

Semi-Permanent Electric Fencing

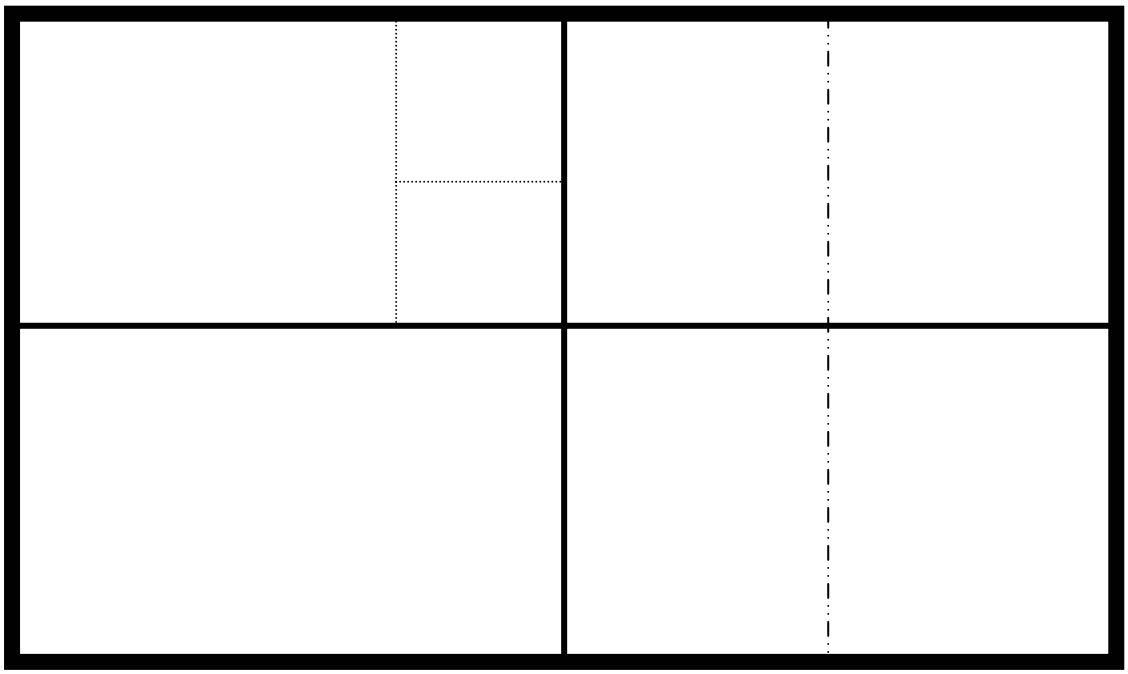
55. Semi-permanent electric fences are typically constructed using permanent posts and polywires or tape that may be detached and reattached to alter the size of paddocks. A common application of semi-permanent electric fences is the management of stock feed during winter months using short-term subdivisions that can be readily reconfigured according to need.

Temporary Electric Fencing

56. Temporary electric fencing is used for rotationally break feeding livestock. Farmers tend to utilise strip grazing in the winter season when grass is less plentiful. A temporary electric fencing system is generally made up of pigtail standards, polywires or tape, reels and a low power battery-operated energiser. This system allows farmers to isolate and easily move livestock between small sections of paddock.

57. Diagram 2 below illustrates how the different types of fencing are typically used on a rural property.

Diagram 2: Fencing on a rural property



Boundary Fence: Likely to be a conventional eight wire fence, sometimes with a single electrified wire (outrigger).

Permanent Subdivision Fence: Likely to be either a 3 wire electric or a conventional eight wire fence.

Semi-Permanent Fence: Likely to be an electric polywire or tape fence.

Temporary Fence: Electric strip grazing fence.

Safety Standards

58. Electric fence energisers (both agricultural and security) for sale in New Zealand are required to meet a number of safety standards in order to be able to be sold.

59. The energiser must comply with the appropriate standards to ensure they neither interfere with, nor are vulnerable to interference from other electronic equipment. These standards are generic for all electronic products, and are based on the international standard.

60. Apart from the United States, most countries (including New Zealand) have a national standard derived from the IEC 60335-1 model standards for general appliance safety. These standards cover all aspects of electrical and fire safety common to all electrical appliances. In the case of countries that have adopted the IEC generic standard (which includes Australia and all of Europe), a compliance certificate from the country of origin would suffice for sale in New Zealand, so there is unlikely to be an additional compliance cost for New

Zealand sales. In the case of product sourced from the United States, some redesign and additional testing to the IEC standard is generally required.

61. Most products currently being sold in Australia and Europe would be acceptable in New Zealand with little more than a procedural standards review. Product currently being sold in the United States would require redesign to suit the safety standards for mains operation.

Security Electric Fencing

62. Industrial fencing is generally used as a security measure to protect a business's stock from theft or damage. Businesses ranging from car yards to freight logistics companies use industrial fencing. As an extra deterrent, industrial fences can be electrified. Industry participants have referred to this additional component to industrial fencing as 'security electric fencing'. The Commission will adopt this naming convention.

63. The same components used to construct a rural electric fence are used to construct a security electric fence. However, a security electric fence also has a controller and an alarm panel that links the electric fencing system to the business's security system. This allows for entry to be easily detected, and for identification of the location of a breach.

64. Security electric fencing is either of the single- or multi-zoned variety. Single-zoned fences are used to secure small areas, while multi-zoned fences are typically used on large properties.

65. Industrial fence contractors construct the industrial fence and purchase the basic steel and wire fencing components from steel distribution companies such as Steel & Tube. The industrial fencing contractor then purchases the security electric fencing component of the industrial fence directly from Gallagher or Tru-Test. Currently, the only suppliers of a complete industrial electric fencing package in New Zealand are Gallagher and Tru-Test.

Conventional Wire Fencing

66. Conventional permanent wire fencing is made up of up to eight wires connected to round-wood posts and separated at intervals by battens. As discussed above, conventional permanent wire fences are predominately used by sheep farmers. Conventional permanent wire fencing systems are also used for boundary fencing by cattle or dairy farmers, or for waterway fencing, as it is provides a greater physical barrier to livestock straying onto roads or into rivers than electric fencing.

67. Installing a conventional permanent wire fence is more expensive than an electric fence due to the extra wire, posts and battens required. However, they tend to represent a one off capital cost and require less maintenance than an electric fence. Conventional permanent wires fences tend to be approximately three to four times more expensive to install.

68. Many farmers use a combination of electric fencing and conventional wire fencing as each type of fencing has special characteristics that are better suited to certain livestock. A farmer may also combine the two types of fencing. For example, many beef farmers use an "outrigger", which is one electrified wire in front of a conventional wire fence. The electrified outrigger improves the lifespan of a conventional wire fence and, in particular, is used to separate bulls.

Gates and Gate Hardware

69. New Zealand farmers use a variety of gates, and their choice of gates appears to be largely based on the type of livestock being farmed or personal preference. Gates are generally wooden or steel and are sold through rural resellers. Farmers routinely bypass their rural reseller and purchase a custom-built gate from a local engineering firm, or construct the gates themselves. Gate hardware consists of hinges, gudgeons, and latches that may need replacing from time to time.

Posts

70. Posts used for permanent wire fencing can be wooden, steel, or concrete. Round-wood treated posts are the preferred choice, and account for 95% of all permanent posts used for permanent wire or electric fencing. Round-wood post suppliers advised the Commission that this was a reflection of the fact that New Zealand has a strong forestry industry, and therefore a ready and cost effective supply. Round-wood posts are chemically treated with CCA (chrome, copper and arsenic) and generally have a fifty year guarantee.

Animal Weighing Systems

71. Many farmers use animal weighing systems as a farm management tool to track an animal's weight and performance. The animal weighing systems have integrated software that is able to store and analyse statistical data about the animals.

72. Animal weighing systems are also used by stockyards, abattoirs and a variety of agricultural industries where animals need to be weighed, and are also used in automated farming systems, such as automated drenching systems.

73. Animal weighing systems tend to be cheaper than industrial scales because animal weighing systems are built to less stringent international metrology standards, and therefore require less sensitive (and less expensive) load cells.

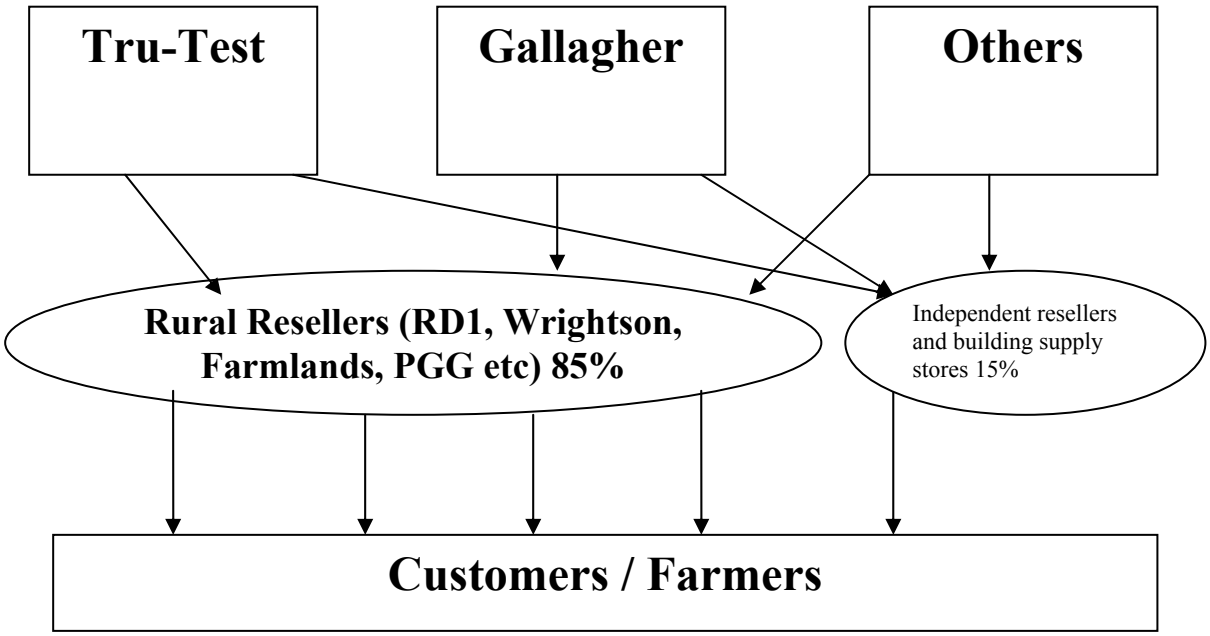
74. The Commission was advised by a number of industry participants that the market for animal weighing systems was still developing. However, there could be scope for growth in the market if New Zealand widely adopted electronic tagging of livestock. If electronic tagging became the norm in New Zealand, animal weighing systems with integrated statistical software, would be well placed to become the statistical recording base for both the animal's weight and a variety of other biodata.

Distribution of Fencing & Agricultural Products

75. Almost all fencing products are sold through rural resellers such as RD1 and Wrightson, as depicted in Diagram 2. The eight largest resellers account for approximately 85% of all fencing retail sales. The remaining 15% is likely to be sold through independent rural resellers or building supply stores. Most suppliers offer rural resellers either flat rebates or volume-based rebates as an incentive to stock their products.

76. The Commission has been advised by a number of industry players that on-line or direct sales represents a very small portion of the retail market.

Diagram 3: Distribution of Fencing and Agricultural Products



MARKET DEFINITION

77. The Act defines a market as:

> . . . a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

78. For competition purposes, a market is defined to include all those suppliers, and all those buyers, between whom there is close competition, and to exclude all other suppliers and buyers. The focus is upon those goods or services that are close substitutes in the eyes of buyers, and upon those suppliers who produce, or could easily switch to produce, those goods or services. Within that broad approach, the Commission defines relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration, bearing in mind the need for a commonsense, pragmatic approach to market definition.[8]

79. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of expansion and entry, would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the five dimensions of a market, three of which are relevant to this case and are discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

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[8] Australian Trade Practices Tribunal, *Re Queensland Co-operative Milling Association* (1976) 25 FLR 169; *Telecom Corporation of NZ Ltd v Commerce Commission & Ors* (1991) 3 NZBLC 102,340 (reversed on other grounds).

80. The Applicant submitted that there are three relevant markets in which there will likely be an aggregation of business activity as a result of the proposed acquisition:

- the manufacture and distribution of rural fencing products to rural resellers in New Zealand (the 'rural fencing market');
- the manufacture and distribution of animal weighing equipment to rural resellers in New Zealand (the 'animal weighing market');
- the manufacture and distribution of industrial fencing products to industrial fencing contractors in New Zealand (the 'industrial fencing market').

81. In defining the relevant markets in which competition is likely to be affected by the proposed acquisition, the Commission has given consideration to the product, geographic, and functional dimensions of the market. The analysis underpinning the Commission's definition of the relevant markets follows.

Product Markets

82. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. For each initial market so defined, the Commission considers whether the imposition of a SSNIP would be likely to be profitable for the hypothetical monopolist. The point at which the SSNIP becomes profitable defines the boundary of the relevant market since no potential substitute beyond this point is sufficiently close to constrain the SSNIP.

83. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market. The degree of demand-side substitutability is influenced by the extent of product differentiation.

84. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

85. Close substitute products on the supply-side are those between which suppliers can shift production easily and in the short-run, using largely unchanged production facilities and little or no additional investment (including investment that would be sunk), when they are given a profit incentive to do so by a small change in their relative prices.

86. In terms of the relevant product dimension, the Applicant has argued for both a broad rural market and a broad industrial fencing market, each encompassing the following product groups:

- electric fencing products – including insulators, lead out and undergate cable, conductive polywires, tapes and braids, fence energisers, and fence testers;
- wire and wire products – including galvanised wire, fabricated wire fences, staples and nails, and fencing tools;
- fence posts – including steel, fibreglass, and wooden post products; and
- gates and gate hardware – including steel gates, wooden gates, electric gates, gudgeons, hinge straps, and gate fasteners.

87. The Applicant recognised that the different product groups identified as falling within the rural and industrial fencing 'markets', respectively, were clearly not substitutable from a demand perspective, but argued for broad markets on the basis that high supply-side substitution might exist:

> …all rural fence products are substitutable on the supply side where it is simple and easy to source or manufacture additional products… A current or potential distributor would simply need to "bundle" the different products required to be in a position to compete directly with the merged entity. (Paragraph 11.4)

88. The Applicant stated near competitors might have the ability to switch or expand supply within rural fencing by virtue of distribution and wholesaling arrangements but the Applicant also recognised that, in general, supply-side substitution would likely be limited with respect to manufacturing (Paragraph 11.4).

89. In arguing for a broad rural fencing market, the Applicant cited the following:

- The Court in *Queensland Wire Industries Pty Limited v The Broken Hill Proprietary Company Limited* (*Queensland Wire*),[9] which makes reference to "the market for the supply of rural fencing materials in Australia";
- Commission Investigation Report – Steel and Tube Holdings Limited/Hurricane Wire Products Limited (23 June 2003), which stated that "gates and fences form part of a broader product market for fencing", as it was considered more appropriate at the time to "treat gates and fences as cluster products, as customers are unlikely to buy fences without gates, and producers of fences are also generally producers of gates"; and
- Commission Investigation Report – Tru-Test Limited/PEL (14 August 2001) and Commission Investigation Report – Tru-Test Limited/Stafix Electric Fencing Limited (27 May 1998) where some arguments in favour of defining a broad market including all types of fencing were set out.

90. In the present application, the Commission explores in detail below how market definition principles apply to this case, particularly with respect to electric fencing products, as the Commission considers that the competition issues raised by the proposed acquisition may vary according to the breadth of the defined market.

91. The Applicants have suggested that the decision of the High Court of Australia in *Queensland Wire* supports the finding of a market for the supply of rural fencing materials. The Commission agrees that there are various references made in *Queensland Wire* to the potential for such a market, but considers that, of itself, is not determinative of the issue. Each case must be considered on its particular facts, and the circumstances in *Queensland Wire* were clearly different to the matter currently before the Commission. In any event, neither the Judge at first instance, nor the High Court, found there to be a market for the supply of rural fencing materials in Australia. Ultimately, the High Court in *Queensland Wire* found that the relevant market for the purposes of the competitive analysis in that case was the supply of steel and steel products.

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[9] *Queensland Wire Industries Pty Limited v The Broken Hill Proprietary Company Limited* (1989) 167 CLR 177

92. In *Steel and Tube Holdings Limited/Hurricane Wire Products Limited* (23 June 2003) the Commission considered the possibility of separate product markets including, among other things, electric fencing products, but in the circumstances found it unnecessary to conclusively determine that issue since the competition implications were the same under both broad and narrow market definitions. As a result, the Commission concluded that if competition concerns did not arise in the narrow market, it was safe to conclude that they would not be found in the broad market.

93. Similarly, in *Tru-Test Limited/PEL* (14 August 2001) and *Tru-Test Limited/ Stafix Electric Fencing Limited* (27 May 1998) the Commission found it unnecessary to conclusively determine whether or not a discrete product market existed for electric fencing systems since the competition implications were again the same under both broad and narrow market definitions.

94. In the present application, however, the Commission must consider more closely whether a broad or narrow product market – particularly with respect to electric fencing products – since in this case the Commission considers that the competition issues raised by the proposed acquisition may vary according to the breadth of the defined market.

95. The discussion below presents the Commission's analysis of the scope for demand and supply-side substitution to occur between the product groups identified by the Applicant.

Rural Electric Fencing Products

Demand-side Substitution

96. Given that both rural electric and conventional wire fencing are used to control and manage livestock, of the four product groups identified by the Applicant as constituting a rural fencing market, these two display the greatest potential to be demand-side substitutes.

97. The Commission consulted widely amongst rural resellers over the demand-side substitutability between electric and conventional wire fencing products. Rural resellers stated that a SSNIP of five to ten percent on the wholesale price of all electric fencing products (imposed by a hypothetical monopolist) would not induce them to substitute towards conventional wire fencing products as they are strongly constrained by the purchasing preferences of their retail customers (users), who tend not to substitute between the two themselves. The rural resellers submitted that, for this reason, they treat the two product categories as being entirely independent of one another when making stocking decisions.

98. For example, [ ] stated:

> … we would not stock more conventional {wire fencing} product in response to a price increase. This is due to the fact that the electric fencing market is different to the conventional {wire fencing} market, serving different needs to our farmer clients. A 5-10% {price} increase will not change our clients farming behaviour and so will not change their buying behaviour…

99. Rural resellers submitted that electric and conventional wire fencing products are not demand-side substitutes for users as:

- electric and conventional wire fences are poor economic substitutes for one another since the cost of conventional wire fencing is significantly greater than the cost of electric fencing; and
- electric and conventional wire fences generally have different practical applications.

100. These two points are considered below in turn.

Economic substitutability

101. Conventional wire fences rely on structural strength to create a physical barrier for livestock. This is achieved through frequent spacing of wooden posts (every five to seven metres with battens in-between to maintain placement and tension of wires) and the use of up to eight high-tensile wires in order to create a secure barrier.

102. In contrast, electric fences rely on a deterrent factor created by the threat of an electric shock (a "psychological barrier") to manage livestock, and so do not require the structural strength of conventional wire fences. For this reason, permanent posts for electric fences may be spaced far less frequently (up to 25 meters apart with naturally-insulated fibreglass standards in-between to maintain tension), and may only require up to three electrified wires in order to secure equine and cattle stock.

103. Hence, the construction of a rural electric fence requires significantly less material and labour than a comparable conventional wire fence. Resellers have submitted to the Commission that, for this reason, the cost to users of constructing conventional wire fences is typically three to four times greater than the cost of constructing electric fences.[10]

104. Resellers also advised the Commission that both fencing systems, if maintained properly, have similar life-spans (usually 10 to 15 years). Hence, electric fences generally prove to be more economical than conventional wire fences.

105. The Commission considers that this pricing difference means that electric and conventional wire fencing are not economic substitutes for users as a hypothetical monopolist could readily impose a SSNIP of five to ten percent across all electric fence products at the retail level without being constrained by the threat or actuality of users substituting in favour of conventional wire fencing on the demand side.

Practical application

106. Since rural electric fences require fewer materials to construct than conventional wire fences, they are also less time-intensive to construct. For example, since an electric fence requires fewer fence posts and less wire than a conventional wire fence, fewer post-holes need to be dug and time-consuming wire knots made. Electric fences can therefore be erected, dismantled, and relocated far more readily than conventional wire fences.

[10] The price comparison made here was between a conventional permanent wire fence and a permanent two to three wire electric fence of comparable length. Temporary and semi-permanent electric fences would arguably be even cheaper to erect since they require even less 'permanent' materials such as softwood posts and high tensile wire.

107. This flexibility allows users to employ electric fencing across a wider range of practical applications than conventional wire fencing. As discussed in the industry background, electric fencing in New Zealand is used commonly in three ways: temporary electric fencing; semi-permanent electric fencing; and permanent electric fencing.

108. In contrast, conventional wire fences are used almost exclusively for permanent fencing needs, since the large opportunity cost of time involved in shifting such fences makes their utilisation for temporary and semi-permanent stock management infeasible. There was industry-wide consensus that, for this reason, users would not substitute conventional wire fencing for temporary or semi-permanent electric fencing, even in the face of a SSNIP of five to ten percent.

109. The Commission observes that both electric and conventional wire fences are used to satisfy permanent fencing needs. However, it is of the view that, as discussed previously, the poor economic substitutability between these two product groups would be likely to prevent conventional wire fencing acting as a constraint on the pricing of electric fencing products, from the perspective of users.

110. There is evidence that the two fencing types are most effective in managing different livestock species. For instance, rural resellers and users submitted to the Commission that electric fencing is particularly effective in managing poorly insulated or large-hoofed animals, such as cattle as they are better earthed and therefore well controlled by the electric deterrent. Charlie Pederson, North Island dairy and beef farmer, stated that dairy and cattle farmers would generally not use conventional wire fences, except on boundary fences that require additional reinforcement to prevent livestock entering neighbouring farms and public access ways. Other users consulted by the Commission supported this view.

111. [ ] and [ ] informed the Commission that electric fencing was often considered a less effective means of stock control for sheep since sheep are generally well insulated by fleece and small-hoofed so earth poorly. As such, conventional wire fencing (including prefabricated netting) is used by many sheep farmers in preference to permanent electric fencing (although some sheep farmers – particularly in the North Island – do use temporary and semi-permanent electric fencing).

112. Given that electric and conventional wire fences tend to be used for different applications, and are also poor economic substitutes for one another, the Commission concludes that there is very little demand-side substitutability between electric and conventional wire fencing products. This has flow on-effects to the willingness of rural resellers to substitute on the demand-side.

113. All rural resellers consulted by the Commission submitted that their purchasing behaviour is strongly constrained by the tastes and preferences of their retail customers. For instance, [ ] stated:

[

].

114. Similarly [ ] stated:

[

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115. The Commission concludes from this that rural resellers are strongly constrained by the preferences of their end-user customers in terms of relative demand for electric versus conventional wire fencing products.

116. As such, the Commission is of the view that if users would not be induced by a SSNIP across all electric wire fencing products at the retail level to switch to using conventional wire fencing products, rural resellers would have no incentive to alter their buying mix between the two categories, even in the face of an across-the-board SSNIP at the wholesale level. Hence, the Commission concludes, on balance, that for the purposes of the present application, there is little scope for demand-side substitutability between electric and conventional wire fencing.

117. With regard to the demand-side substitutability between electric fencing products, fence posts, and gates and gate hardware, it is clear that users employ these rural products for entirely different practical applications. On this basis, the Commission concludes there is no demand-side substitution between electric fencing products, fence posts, and gates and gate hardware.

Supply-side substitution

118. As discussed previously, the Applicant has argued in favour of a broad product market on the basis that high supply-side substitution may exist between the four product groups within what the Applicant has referred to as the "rural fencing market". In particular, the Applicant contended that a supplier of other rural fencing products (conventional wire fencing products, fence posts, or gates and gate hardware) would simply need to outsource and "bundle" items across the four product groups in order to be able to compete directly with the combined entity. The Commission would consider suppliers with the ability to do this as near competitors.[11]

119. The Commission addressed this argument put forward by the Applicant by exploring the scope for supply-side substitution to occur between electric fencing products and conventional wire fence products, fence posts, and gates and gate hardware. Supply-side substitution could potentially occur in two ways:[12]
    - near competitors (if any) quickly (within one year) modifying their current production processes, without incurring significant additional investment, in order to supply electric fencing products; or

[11] The Commission defines 'near competitors' as potential suppliers who could and would modify their production or distribution arrangements to switch quickly, within one year, to supply the product in question. By virtue of their ability to switch production readily, near competitors would be considered to be 'in' the relevant product market. The Commission considers near competitors to be distinct from potential 'new entrants', who are those suppliers that are not in the market currently (that is, they are not existing competitors), but could enter the market within a period normally of about two years, given the appropriate incentives to do so. Discussion of potential new entry is deferred to the competition analysis.

[12] The prospect of new entry, or expansion by existing competitors, is discussed in the Competition Analysis.

- near competitors (if any) quickly (within one year) altering their distribution arrangements such that they effectively became wholesalers of electric fencing products.

120. Following industry-wide consultation, the Commission is of the view that, on balance, it would be very unlikely that any supplier of other rural fencing products could manufacture and supply a range of electric fencing products – particularly energisers – without significant additional investment in capital such as plastic moulding equipment (to produce insulators and other insulated products, reels, casing for energisers, etc) and electronics manufacturing equipment (to produce energisers), given that no such supplier presently has these capabilities in any significant way.

121. A recent example is illustrative: O'Brien recently developed a single low-powered (0.1 joule, output) strip-grazing energiser in-house at a cost of [ ]. [ ], an independent engineer who developed this energiser for O'Brien, estimated that the research and development cost of producing a 2 joule and 5 joule (output) energiser would be approximately [ ], a 10-20 joule (output) energiser approximately [ ] and a 36 joule (output) energiser approximately [ ]. Additionally, [ ] informed the Commission that the cost of establishing a facility to build the electrical componentry for energisers would be approximately [ ] and plastics tooling for energiser casings would cost a further [ ].

122. Rural resellers placed emphasis on any supplier being capable of offering a full energiser range before they would considering stocking the brand. Existing competitors have suggested that in order to successfully gain access to rural resellers, a supplier would need to be able to offer at least [ ]. Based on submissions made by [ ] and other industry participants, the Commission estimates the cost of achieving this level of supply to be approximately [ ].

123. Given the extent of additional investment a supplier of other rural fencing products would have to make in order to switch existing production to manufacture and supply electric fencing products, the Commission concludes that there is little or no scope for supply-side substitution to occur (via manufacture) between electric fencing and conventional wire fence products, posts, and gates and gate hardware. This conclusion is consistent with the Applicant's view:

> In terms of manufacturing, some products will be substitutable from a supply perspective, although it is fair to say such instances between the different product groups identified will be limited.

124. The Applicant has further argued that suppliers of other rural fencing products could readily switch supply into electric fencing products by simply outsourcing and 'bundling' together electric fencing products that it either could not, or would not, manufacture itself. That is, supply side substitution could occur by virtue of wholesaling and distribution arrangements.

125. The Commission considers that this is likely to be true to some extent. For instance, many 'commodity' or low-technology electric fencing products (e.g., insulators, pigtail standards, or polywire and tape) are relatively homogeneous products with many existing producers, both domestically and abroad.

Therefore, these items could potentially be outsourced readily from other existing suppliers and contract manufacturers.

126. Donaghys Industries Limited, a New Zealand producer of twine and cabling, is a good example of a potential outsourcing option for polywire and tape. Similarly, any number of plastic contract manufacturers could produce insulators and other insulated products.

127. It is also likely that these supply relationships could be established within the short timeframe of a year that the Commission considers when examining the scope for supply-side substitution.

128. Hence, it is feasible that supply-side substitutability may exist with respect to many of these commodity items, via wholesaling and distribution arrangements.

129. However, the Commission does not consider that this would also be true with respect to energisers. Energisers, in general, are technologically complex products, in contrast to the accessory products that make up the remainder of the electric fencing category. They are highly differentiated ranging from very low power models (0.04 joules, output) for strip grazing a small area (maximum one kilometre of fence-line), to very high-power units (up to 36 to 50+ joules, output) that are suitable for large farms (maximum 360 kilometres of fence-line).

130. Energisers have evolved to cater for a range of fencing needs. For instance, some energisers are very portable and self-contained (i.e. battery and/or solar powered units), ideal for remote locations where there is no access to a power source. They can also be fixed at a home base and used to power all the fencing on an entire farm (large battery and mains powered units).

131. Of all the products in the electric fencing category, energisers have seen the most innovation over the past five to ten years. Most medium to high-power energisers (6+ joules, output) have built-in microprocessors with load-sensing, fault detection, remote control, and cyclic wave technology[13] as standard features. Recent advances include high-end energisers with comprehensive farm-monitoring capability, which includes remotely sensing if farm gates and building doors are shut, as well as monitoring water towers from the home base, and 'smart-energisers' that can report faults along a fence-line by text messaging the farmer's mobile phone.

132. Post-acquisition, O'Brien and PEL would be the only domestic suppliers of energisers, other than the combined entity. Therefore, suppliers of other rural fencing products would only be able to potentially outsource energisers from these two firms in order to compete directly with the combined entity. However, neither O'Brien nor PEL presently have complete energiser ranges, which, as discussed later in the competition analysis, are essential in order to gain acceptance from resellers.

133. As noted earlier, O'Brien presently only has a low-power strip-grazing unit in its energiser range. [

[13] Cyclic wave technology (patent held by Tru-Test) allows a more powerful and continuous pulse to be generated by the energiser. This allows the pulse to travel further along the fence-line, thus making more efficient use of the current being generated by the unit.

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134. PEL does not have a top-end (36 joule) energiser offering, rendering its range incomplete. In addition, there are a number of concerns relating to the obsolescence of the technology in the current PEL energiser range as discussed more fully in the competition analysis. Industry participants have indicated that it would take over two years for an independent owner of PEL to develop a complete energiser range that would be acceptable to resellers. This is outside the one-year timeframe the Commission uses in assessing the scope for supply-side substitution.

135. The competition implication of this is that, post-acquisition, there would be no domestic supplier of energisers where a full energiser range (as required by resellers) may potentially be outsourced, within the one year timeframe used by the Commission in assessing the scope for supply-side substitution. The Commission therefore concludes that supply-side substitution into electric fencing products (energisers, in particular) could not occur via domestic outsourcing.

136. Given this conclusion, the Commission has not been required to consider whether or not O'Brien and PEL, assuming either or both had a complete energiser range, would supply an outsourcing competitor.

137. Currently, there are also two imported energiser brands available in New Zealand – Red Snap'r and Thunderbird. These brands have experienced very low uptake by the eight main rural resellers. Daken, an Australian supplier of energisers and other electric fencing products, has also attempted to enter New Zealand on a number of occasions but has failed to do so. Rural resellers have cited to the Commission a number of reasons why they believe imported energisers would achieve only limited penetration into New Zealand:

    - unsuitability for the needs of the New Zealand users;
    - quality concerns; and
    - limited technical support.

138. These concerns are discussed in further detail in the competition analysis, but are briefly touched on here for the purposes of defining the relevant product market.

139. The Commission considers that, currently, overseas suppliers are unlikely to be able to supply a range of electric fencing products that would be satisfactory to rural resellers, particularly in terms of high-power energisers. This is because there has historically been limited demand for these types of energisers internationally so overseas suppliers have had little incentive to develop such a range. The Applicant has submitted that in contrast, approximately [ ] of all energisers sold in New Zealand are high-power energisers.[14]

140. Furthermore, the Commission considers that a combination of factors including: the limited size of the export market (and therefore limited scope for return on

[14] A discussion of why high-power energisers are less prevalent in overseas markets than in the New Zealand market can be found in the 'Sourcing from Overseas' section of the Competition Analysis.

investment in research and development); a potentially high opportunity cost of funds; and import-related costs, means overseas suppliers are unlikely to develop a high-power range of energisers to supply into New Zealand in the near future. Thus, no supplier of other rural fencing products is likely to be successful in outsourcing high-power energisers from overseas in order to make up the full energisers range that resellers require before they are willing to consider stocking.

141. The Commission also accepts the argument of resellers and users that imported electric fencing products – particularly technology-driven items such as energisers – are likely to receive poor acceptance locally, given the high quality and recognition behind existing brands in New Zealand. In making this assessment, the Commission was influenced by statements made by a broad cross-section of industry participants including rural resellers, existing competitors, potential entrants, and users. This is more fully discussed in the Competition Analysis.

142. The Commission is of the view that a near competitor could contract out technical support and servicing of energisers to a large number of electronics companies and independent engineers. The Commission therefore places less weight on the concerns of rural resellers that imported energisers would not have sufficient technical support and servicing arrangements to warrant stocking.

143. Having considered all the arguments put before it, for the purposes of the present application, the Commission concludes that there would be only very limited scope for supply-side substitution (via either in-house manufacturing or outsourcing) to occur between electric fencing products and conventional wire fencing products, fence posts, and gates and gate hardware.

Security Electric Fencing Products

144. The Applicant argued that security electric fencing products should be defined within some broad product market for "industrial fencing" products, which would also include industrial wire fencing products, fence posts, and gates and gate hardware.

145. The Commission is of the view that poor scope for demand-side substitution exists between security electric fencing products and other industrial fencing products on the basis that security electric fencing performs a specialised function not offered by other industrial fencing products. Specifically, security electric fencing acts as a deterrent to intruders via the threat of an electric shock, and also allows detection of breaches through monitoring systems and interface with visual and audible alarms. For this reason, security electric fencing products and other industrial fencing products are more likely to be complements than demand-side substitutes.

146. The Commission is also of the view that poor scope for supply-side substitution exists between security electric fencing products and other industrial fencing products, given the large differences between the respective manufacturing processes. Specifically, the manufacture of security electric fencing products requires access to injection-moulding technology, as well as specialised equipment for producing electronics, which is not necessary to produce industrial wire fencing products, fence posts, or gates and gate hardware. This

would make it difficult for potential near competitors to readily switch production into security electric fencing products.

147. For these reasons, the Commission concludes that it would be inappropriate, for the purposes of the present application, to define security electric fencing products within some broad industrial fencing market. However, given their similarities, the Commission examined the possibility of defining security electric fencing products within the same product market as rural electric fencing products.

Demand-side substitution

148. Industry participants have informed the Commission that the materials used to construct both permanent rural and security electric fences are very similar. Both employ energisers, insulators, fencing wire, wire strainers, etc. Most of the non-electronic items are identical, in terms of functionality, across both types of electric fencing. The main differences that may hinder demand-side substitutability lie in the electronic products.

149. A key functionality of security electric fences is their ability to detect tampering or intruder breaches. This detection capability is achieved using Fence Voltage Alarms (FVAs), which are typically built into the security energisers, and alarm panels (usually sourced separately from specialist alarm companies) that receive signals from the FVAs and output these to visual or audible alarms and/or a security monitoring company.

150. Users of rural electric fencing typically do not require such intruder detection capability, although many find it advantageous to detect short circuits resulting from excess loads on the fence-line. Hence, some rural energisers (e.g. the Gallagher MBX2500 and MBX1500) also have integrated FVAs and can be installed with a live wire return, which can be connected to an alarm panel. It is also possible to purchase separate FVA units to combine with rural energisers without integrated alarm units.

151. As discussed in the 'industry background' section, security electric fencing can either be single-zoned or multi-zoned. Single-zoned fences use single-channel energisers. There do exist rural energisers that offer the same (if not greater) functionality as these single-channel security energisers. For instance, Gallagher's MBX1500 (15 joules, stored) rural energiser has a similar power rating to the Medal 1000 (10 joules, stored) security energiser. Both have integrated FVAs and are similarly priced at [ ] and [ ], respectively. The only technical difference between these two products is that the rural energiser has the added functionality of adaptive control (capability to automatically adjust fence voltage according to fence load) whereas the security energiser does not.[15]

[15] Some rural energisers are designed to be responsive to load changes (adaptive control), which is advantageous in the rural context. For instance, a slow load increase (e.g., vegetation growing on to the fence over time) would see a gradual step-up in power to avoid short circuits, whereas a sudden load increase (e.g., an animal becoming entangled in the wires) would prompt a rapid step-down in power in order to avoid electrocution. Security energisers typically do not require such adaptive control since users are typically seeking to deter intruders or detect breaches – neither of which needs this feature.

152. Given that both types of energiser offer very similar functionality, it is possible that users of single-zone security fences could readily substitute between rural and security electric fencing products, and Bill Gallagher, CEO, Gallagher, cited to the Commission a few instances where this has already taken place.

153. However, the bulk of demand tends to be for multi-zone security electric fences.[16] The Commission considers that there is poor substitutability on the demand-side between rural and multi-zone security electric fencing products, especially with respect to energisers.

154. As discussed in the background section, multi-zoned fences are typically constructed using energiser units with multi-channel energisers (controllers). For instance, Gallagher's six-zone energiser unit has two three-channel controllers, all housed within the same plastic casing. The Applicant submitted to the Commission that rural energisers were substitutable for multi-zoned security energisers since the same multi-zoning functionality could be achieved by using multiple single-channel rural (or security) energisers in place of a sole multi-zone energiser unit.

155. However in discussions with Commission Staff, Bill Gallagher acknowledged that employing "more than two" single-channel energisers as a substitute for a sole multi-zone energiser, would be "quite a disadvantage" from a performance and safety standpoint. Multi-zone energisers are designed so that the individual controllers are synchronised to pulse less than once per second in order to lower the risk of electrocution. Bill Gallagher informed the Commission that synchronising multiple single-channel energisers to the same level as a dedicated multi-zone system would be difficult to achieve, so in practice users tend not to substitute between rural and security electric fencing products when constructing multi-zone fences.

156. The cost of bundling together multiple rural energisers as a substitute for a sole multi-zone security energiser would also prove to be prohibitive. For instance, Gallagher's Trophy 3 (three-zone) system presently has a trade price of [ ]. The trade cost of three MBX 1500 rural energisers is [ ]. Similarly, Gallagher's Trophy 6 (six-zone) system has a trade price of [ ]. The trade cost of six MBX 1500 rural energisers is [ ].[17] Hence rural and security electric fencing products are clearly poor economic substitutes.

157. In summary, the Commission concludes that rural and multi-zone electric fencing products (energisers in particular) are not substitutable on the demand side due to the practical difficulties of synchronising multiple single-channel energisers, as well as the large pricing differential between the two fencing types. Some substitution appears to be possible at the fringe between rural and single-zone electric fencing products, however, since the bulk of demand for security electric fencing lies in multi-zoned as opposed to single-zoned fences, this switching is unlikely to be sufficient to make a SSNIP of five to ten percent unprofitable.

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[16] Bill Gallagher informed the Commission that [ ] of Gallagher's security electric fencing customers purchase for multi-zoned fences, and Tru-Test estimated that [ ] of their security fencing customers purchase for multi-zoned fences.

[17] Rural and security electric fencing accessories (strainers, insulators, etc.) however tend to be similarly priced.

Supply-side substitution

158. Both Gallagher and Tru-Test – the only two manufacturers of security electric fencing in New Zealand – utilise the same plant, equipment, and production process to produce both rural and security electric fencing products. For example, the same injection moulding equipment (with a simple change-over in dyes) is used to produce insulated products and energiser casings, regardless of whether these products are for rural or security electric fencing use. Similarly, the same [

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159. Production switching costs are also minimal, or zero in some cases, and because the materials and labour used to produce both types of electric fencing products are often identical, [ ]. Bill Gallagher stated:

[ ]

160. Given the lack of product-specific assembly lines and low switching costs, the Commission concludes that a high degree of supply-side substitution is possible between rural and security electric fencing products. The Commission considers that the existence of such strong supply-side substitutability would be sufficient to bring rural and security electric fencing products into the same product market.

Conclusion on electric fencing products

161. The Commission is of the view that, for the purposes of the present application, rural electric fencing products should not be defined within the same product market as conventional wire fencing products, fence posts, and gates and gate hardware, given the poor scope for both demand-side and supply-side substitution to occur between these product categories.

162. The Commission is also of the view that, for the purposes of the present application, rural electric fencing products and security electric fencing products should be defined within the same product market, due to the strong supply-side substitutability that exists between the two product categories.

163. The Commission therefore concludes, for the purposes of the present Application, that a product market exists for rural and security electric fencing products.

Conventional Wire Fencing Products

Demand-side substitution

164. As alluded to before, conventional wire fencing products – which include steel wire, pre-fabricated mesh or netting, nails and staples, non-insulated strainers, and tools – are employed by rural users for very specific applications. In particular, as discussed previously, conventional wire fencing in New Zealand is used only to carry out permanent fencing since the cost of shifting conventional wire fences makes them prohibitively expensive for temporary and semi-permanent fencing. Industry participants including rural resellers and users have informed the Commission that boundary fences on farms are almost exclusively constructed using conventional wire products because:

- boundary fences are rarely shifted; and

- the structural strength of conventional wire fences provides users with increased certainty that livestock cannot enter neighbouring farms, roads, or public access ways.[18]

165. Users have also informed the Commission that conventional wire fences are employed along 'pressure points' on a farm where there may be a concentration of livestock in a small area. A good example of such pressure points are narrow animal walkways used to manoeuvre animals to and from sheds. Electric fencing would be unsuitable for this purpose because a large number of animals could easily break through the fence-line together.

166. Finally, as discussed earlier, some users – particularly deer and high country sheep farmers in the South Island – prefer conventional wire fencing (prefabricated netting or wire) over electric fencing in order to control stock.

167. Therefore, as emphasised in the preceding section, users purchase conventional wire and electric fencing for quite different applications. Given that users tend to purchase conventional wire fencing products to address specific needs that cannot be met effectively by electric fencing products, they are unlikely to substitute between the two, even in the face of a SSNIP across all conventional wire products at the retail level.

168. Similarly, for reasons analogous to those given in the previous section the Commission considers that fence posts and gates and gate hardware are not substitutes for conventional wire fence products – fence posts and gates and gate hardware are used by farmers in entirely different applications to conventional wire fencing products, so substitution between these product categories would not occur, even in the face of a SSNIP across all electric fencing products at a retail level.

169. As argued previously, rural resellers appear to be constrained by the tastes and preferences of their retail customers, so tend to stock what users demand. If users would not be induced by a SSNIP at the retail level to switch consumption between conventional wire and electric fences, or fence posts, or gates and gate hardware, resellers would have little incentive to alter their own demand for these other categories, even in the face of a SSNIP at the wholesale level. In other words, resellers could feasibly pass on a SSNIP at the wholesale level to retail customers without having to substitute their own stocking of conventional wire fencing for electric fencing products, or fence posts, or gates and gate hardware.

170. The Commission therefore concludes, for the purposes of the present application, that there is poor scope for demand-side substitution between conventional wire fencing products and electric fencing products, fence posts, and gates and gate hardware.

Supply-side substitution

171. The Commission also examined the scope for supply side-substitution to occur between conventional wire fencing products and electric fencing products, fence posts, and gates and gate hardware. Supply-side substitution could potentially occur in two ways:

[18] As discussed previously, electrified wires – 'outriggers' – are often used in conjunction with conventional wire fences on boundaries to provide added security in this regard.

- near competitors (if any) quickly (within one year) modifying their current production processes without incurring significant additional investment, in order to supply conventional wire fencing products; or
- near competitors (if any) quickly (within one year) altering their distribution arrangements such that they effectively became wholesalers of conventional wire fencing products.

172. Currently, Pacific Wire is the only manufacturer of galvanised fencing wire in New Zealand, although there are many suppliers including, Hurricane, Tru-Test, Eurocorp, and a number of smaller players. Eddie Bennett, Business Unit Manager, Pacific Wire, informed the Commission the following production inputs would need to be secured before manufacture of galvanised fencing wire could be commenced:
    - access to materials (steel rod, which is produced from raw billet at a rolling mill); and
    - investment in wire drawing equipment and galvanising plant.

173. Eddie Bennett stated that sourcing of steel rod (the primary material input in producing galvanised fencing wire) is generally achieved by manufacturers through vertical integration links with steel rolling mills, which in turn are vertically linked to steel mining companies. For instance, Pacific Wire (manufacturers of galvanised wire) source their steel rod from an associated company Pacific Steel (operators of steel rolling mills), who in turn are supplied raw billet by the parent company, Fletcher Steel.

174. Eddie Bennett stated that these supply arrangements were typical amongst manufacturers of galvanised fencing wire, illustratively citing Smorgon and One Steel – the only two galvanised fencing wire manufacturers in Australia – as having similar vertical integration. Eddie Bennett further stated that such vertical links were essential for manufacturers in order to ensure a steady supply of raw material. The Commission notes that these secure supply links are likely to become important for manufacturers to mitigate steel shortages, such as the one presently being experienced globally.

175. Eddie Bennett also informed the Commission that a near competitor would need to make significant additional investment in plant and machinery in order to manufacture galvanised fencing wire. In particular, the cost of acquiring a single new wire drawing machine would be approximately [ ], although second-hand equipment could be obtained at a cost of approximately [ ]. Pacific Wire has [ ]. A galvanising plant would cost a further [ ], approximately.

176. Hurricane also produces prefabricated netting for rural use, [ ]. Nick Calavrias, Managing Director, Steel and Tube, advised the Commission that a manufacturer of prefabricated netting would require wire fabrication machinery costing [ ], though noting that cheaper second-hand machinery could be purchased at a cost of approximately [ ]. Hurricane has [ ].

177. Following consultation with existing suppliers, the Commission is of the view that no supplier of other rural fencing products could modify their existing production process to manufacture conventional wire fencing products without

incurring significant additional investment, and as a result, very little scope for supply-side substitution via manufacturing exists. This, along with the poor scope for demand-side substitution between conventional wire fencing products and electric fencing products, fence posts, and gates and gate hardware, suggests that conventional wire fencing products should be defined as a discrete product market.

178. However, the Commission recognises that more scope exists for supply side substitution via wholesaling and distribution arrangements. Given the appropriate incentives (i.e. if sufficient margins could be achieved, or significant benefits could be generated by bundling conventional wire fencing products with other fencing products), a supplier of other rural fencing products may be able to outsource conventional wire fencing products from existing suppliers, and on-sell these to resellers.

179. Wholesaling arrangements already exist in the industry. For example, [ ] simply on-sell [ ] purchased either locally or from overseas. The potential for suppliers of other rural fencing products to outsource and bundle conventional wire fencing products suggests that conventional wire fencing products could be defined as falling within some broader market.

180. Given that there are arguments in favour of both a narrow and broad product market with respect to conventional wire fencing products, the Commission will, for the purposes of the present application, adopt the conservative approach of defining a discrete product market for conventional wire fencing products. The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

Rural Fence Posts

181. A wide variety of post types are used for rural fencing in New Zealand such as softwood, steel, plastic, fibreglass, concrete, and imported hardwood.

182. Whilst fence posts display strong complementarities to other fencing products (such as gates, wire, and energisers), they are clearly not substitutable for these products on the demand side. Posts carry out the specialised function of supporting and adding structural strength to fences, which products in other fencing categories do not perform. This specialisation of use means users would not substitute to using electric or conventional wire fencing products, or gates and gate hardware, in the face of a SSNIP across all fence post products.

183. There is also weak scope for supply-side substitution in terms of the manufacture of fence posts. [ ], informed the Commission that a supplier of other rural fencing products (electric or conventional wire fencing products, or gates and gate hardware) would require substantial additional investment in plant and machinery (for peeling, steaming, and chemically treating timber) at a cost of between [ ], approximately, in order to switch to the manufacture of softwood posts and compete effectively.

184. Suppliers of other rural fencing products would also need to incur significant additional investment in capital in order to switch production to steel posts. For instance, Hurricane (who supply steel products such as wire and netting)

recently [

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185. Similarly, the manufacture of fibreglass standards (typically used for semi-permanent electric fencing) would require investment in expensive pultrusion technology,[19] and the production of concrete posts (e.g., for gates) would require additional investment in moulds and casting, as well as concrete mixing equipment. Hence, the Commission is of the view that, for the purposes of the present application, there is little scope for supply-side substitution in terms of manufacture into softwood, concrete, and fibreglass posts.

186. The Commission recognises, however, that more scope exists for supply-side substitution into the manufacture of plastic posts since any supplier currently producing plastic fencing products (such as insulators or energiser casings) could use existing injection-moulding capability to produce plastic posts, having only to invest in new moulds.

187. The Commission also recognises that it may be possible for supply-side substitution to occur via wholesaling arrangements between near competitors and existing suppliers of posts. Given the appropriate incentives (that is, if sufficient margins could be achieved, or if there were significant benefits in bundling posts with complementary fencing items), suppliers of other fencing products could act as wholesale agents of posts by either contract manufacturing posts or purchasing directly from existing suppliers, and then on-selling these items to rural resellers. This possibility suggests that fence posts could be defined within a broader product market encompassing other rural fencing products.

188. Given that there are arguments in favour both a narrow and broad product market with respect to fence posts, the Commission will, for the purposes of the present application, adopt the conservative approach of defining a discrete product market for fence posts. The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

Gates and Gate Hardware

189. [

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190. In forming a view on the appropriate definition of the product market, the Commission reverted to its usual approach of examining the scope for demand- and supply-side substitution to occur.

[19] *Pultrusion* is a continuous process in which a thermosetting polymer (a resin) and reinforcement fibres (for example, glass) are 'pulled' and moulded into a desired profile such as rods for making fibreglass standards.

Demand-side substitution

191. Gates and gate hardware, like fence posts, have a specialised use on farms. They are used in the rural setting to create controlled thoroughfares for livestock, vehicles, and people between two sections of land separated by fence-line. Given this specialised function for gates and gate hardware, the Commission considers that there is little scope for users to substitute in favour of electric fencing products, conventional wire fencing products, or fence posts, even in the face of a SSNIP across all gates and gate hardware.

192. The inability of retail customers to substitute across fencing categories creates little incentive for resellers to substitute across categories when purchasing from suppliers, even in the face of a SSNIP at the wholesale level. In other words, resellers are likely to purchase fewer rural gates and less gate hardware in the face of a price rise, but are unlikely to purchase more electric fencing products, conventional wire fencing products, or fence posts by virtue of their demand-side substitutability for gates and gate hardware.

Supply-side substitution

193. The Commission also examined the scope for supply-side substitution to occur between rural gates and gate hardware, and electric fencing products, conventional wire fencing products, and fence posts. Steve Williams, General Manager, Greyson, informed the Commission that the processes for manufacturing gates and gate hardware are entirely different to the processes for manufacturing these other rural fencing products. As a result, investment in pipe-bending and welding equipment (costing approximately [ ]) would be required in order to produce competitive quantities of gates.

194. Brian Walker, General Manager, Walker Ltd, advised the Commission that the cost of machinery (power presses, punching machines, welders, and threading machines) and tooling required to manufacture gate hardware competitively would amount to approximately [ ].

195. Given the additional investment in capital required in order for suppliers of other rural fencing products to switch production to gates and gate hardware, the Commission is of the view that poor supply-side substitutability exists in terms of manufacturing. However, as in the case of conventional wire fencing and fence posts, the Commission acknowledges that scope may exist for near competitors to substitute on the supply side by outsourcing gates and gate hardware.

196. Brian Walker, Walker Ltd, informed the Commission that rural gates and gate hardware are commodity-type products that are not characterised by frequent technological innovation. As such, there are many existing suppliers of rural gates and gate hardware, including specialist firms such as Greyson and Walker, as well as many smaller independent engineering firms from where these products could be outsourced. Given the appropriate incentives (that is, if sufficient margins could be achieved, or if there were significant benefits in bundling rural gates and gate hardware with complementary fencing products), it may be possible for suppliers of other rural fencing products to wholesale and distribute contract manufactured gates and gate hardware.

197. Given that there are arguments in favour both a narrow and broad product market with respect to gates and gate hardware, the Commission will, for the

purposes of the present application, adopt the conservative approach of defining a single product market that includes rural gates and gate hardware. The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

198. It may also be possible to define rural gates as falling in a separate product market to rural gate hardware. However, the Commission considers that, for the purposes of this application, the implications for the competition analysis would be the same under a broader market definition. Therefore it is not inappropriate to treat gates and gate hardware as falling in the same product market, in this instance.

Animal Weighing Systems

199. The Applicant suggested a discrete product market exists for animal weighing systems, which includes weighing indicators and load bars, as well as accessories (weighing platforms, statistical software, etc.). In reaching a view on the relevant market, the Commission considered whether the definition of the product market should be broadened to include industrial weighing equipment. In doing so, the Commission considered the scope for demand-side substitution to occur between animal weighing systems and industrial weighing equipment.

Demand-side substitution

200. Manufacturers of both weighing systems informed the Commission that animal weighing systems and industrial weighing equipment are poor economic substitutes for one another, due to differences in the material inputs used in production. Suppliers of industrial weighing equipment are governed by stringent international legal metrology standards that require that industrial scales have a high degree of accuracy. In order to meet these standards, industrial weighing load bars require highly sensitive, and expensive, load cells.[20] Animal weighing system's load bars are not governed by the same high metrology standards so cheaper, less sensitive, load cells are generally used. As a result, animal weighing systems are often significantly less expensive than load-comparable industrial weighing systems.

201. For instance, Tim Russell, Managing Director, Iconix informed the Commission that a basic two-tonne industrial weighing system would cost users approximately [ ] to purchase. In contrast, a comparable animal weighing system capable of weighing two-tonne loads would cost approximately [ ]. Hence, a hypothetical monopolist could feasibly impose a SSNIP of five to ten percent across all animal weighing systems without being constrained significantly by users switching in favour of industrial weighing systems.

202. On this basis, the Commission concludes, for the purposes of the present application, that animal weighing systems and industrial weighing equipment are poor substitutes on the demand side.

[20] Load cells are the sensor component in a weight-indicator system that detects the tensional or compressional forces being imparted to the running string at surface. Load cells are hydraulically or electronically operated and are connected to the weight-indicator display system on the equipment operator's console.

Supply-side substitution

203. The Commission also examined the scope for supply-side substitution to occur between animal weighing systems and industrial weighing equipment. Manufacturers of both animal and industrial weighing equipment have advised the Commission that the process for assembling both types of systems is identical and no further additional investment in plant or machinery would be required in order to switch production from industrial weighing equipment to animal weighing systems. [

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204. [ ] also informed the Commission that a manufacturer of industrial weighing equipment would need to incur some additional design costs before manufacture could be switched to animal weighing systems.

205. Firstly, since the cost of more sensitive load cells is typically built into the final price of industrial weighing systems, systems using the same load cell technology could not be priced competitively, relative to existing animal weighing systems on the market. In order to price competitively, a near competitor would need to redesign the electronics of the system in order to incorporate more cost-effective load cells.

206. Secondly, by necessity, the load cells used in animal weighing systems are encased within the load bar to prevent exposure to moisture and dirt. However, load cells used in industrial weighing systems are generally exposed. Hence, a manufacturer of industrial weighing equipment would need to redesign its load bars with suitable casing in order to meet the needs of agricultural users.

207. [

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208. Despite these design costs, however, the Commission notes that there is evidence of past supply-side substitution in the industry between industrial weighing equipment and animal weighing systems. Atrax and Sensortronic are both suppliers of industrial weighing equipment who also produce and distribute small quantities of animal weighing systems, and therefore appear to have overcome the design hurdle. Iconix entered the industry as a supplier of industrial weighing equipment, but switched to exclusively producing animal weighing systems in 1987.

209. In conclusion, there appears to be clear evidence of poor demand-side side substitutability between animal and industrial weighing equipment, which suggests a narrow definition of the market should be adopted. The evidence on supply-side substitutability is less conclusive. There do appear to be reasonably significant costs associated with switching production between the two types of weighing systems, although a history of the industry suggests that firms have been willing and able to make this switch. This suggests supply-side substitution may be feasible, and therefore a broad definition of the market could be adopted.

210. Given that there are arguments in favour both a narrow and broad product market with respect to animal weighing systems, the Commission will, for the

purposes of the present application, adopt the conservative approach of defining a discrete product market for animal weighing systems. The Commission recognises that if competition concerns are not identified within a narrowly defined market, they are unlikely to arise in a more broadly defined market.

Conclusion on Product Markets

211. For the purposes of the present application, the Commission concludes that the relevant product markets are:

- rural and security electric fencing products;
- rural conventional wire fencing products;
- rural fence posts;
- rural gates and gate hardware; and
- animal weighing systems and accessories.

Functional Market

212. The production, distribution, and sale of a product typically occurs through a series of functional levels, conventionally arranged vertically in descending order. Generally, the Commission identifies separate relevant markets at each functional level affected by an acquisition, and assesses the impact of the acquisition on each.

213. All suppliers of rural electric fencing products, conventional wire fencing products, fence posts, gates and gate hardware, and animal weighing equipment in New Zealand act as wholesalers to rural resellers. Rural resellers in turn retail these products to users. In the case of security electric fencing, the electrification of these fences will typically be sub-contracted by the installer of the security electric fence. No supplier of these products currently sells directly to users, so there is a clear demarcation between the wholesale and retail functional levels of the market.

214. The Commission recognises that wholesale supply across these product categories is presently achieved in two ways. Suppliers manufacture the products themselves (either in-house or through contract manufacturing arrangements), or import the finished product from overseas in order to on-sell to resellers.

215. Local manufacture is by far the most common method of supply in the product markets identified. For instance, the vast majority of electric fencing products and fence posts supplied in New Zealand are manufactured domestically. Similarly, all prefabricated conventional wire fencing, gates and gate hardware, and animal weighing equipment sold in New Zealand is also manufactured locally.

216. Some galvanised wire, nails, and staples used in conventional wire fencing are imported directly from overseas. Additionally, small quantities of hardwood posts (from Australia) and the Red Snap'r brand of electric fencing products (U.S.) are being imported into New Zealand.

217. The Commission concludes, for the purposes of the present application, that the relevant functional market is the manufacture and wholesale supply of electric

fencing products, conventional wire fencing products, fence posts, gates and gate hardware, and animal weighing equipment.

Geographic Markets

218. The Commission defines the geographic dimension of a market to include all of the relevant spatially dispersed sources of supply to which buyers would turn, should the prices of local sources of supply be raised. In doing so, the Commission considers the extent to which prices in one geographic location are related to prices in another and the extent of product flows between possible local markets.

Electric Fencing

219. Suppliers of electric fencing products such as Gallagher and Tru-Test advised the Commission that prices are set on a national basis so that all resellers faced a "national list price" (although different resellers receive different rebates according to their individual rebate structures and the volume of sales being pushed through).

220. All resellers confirmed to the Commission the assertion that pricing for electric fencing products is set nationally such that there are no variations in prices across regions. Resellers also indicated to the Commission that that in the face of a local SSNIP, transport costs (freight and handling) would unlikely be so high as to deter them from sourcing electric fencing products from different regions, particularly if a batch-order (as opposed to single-order) system was used. [ ] further stated that it "would be extremely inconvenient to run national promotions" if prices varied across regions and as such it is likely that national resellers would shift demand in such a way as to achieve a single buying price across all regions. On this basis, the Commission concludes that the market for the manufacture and wholesale supply of electric fencing products is a national one.

Conventional Wire Fencing & Fence Posts

221. The Commission found some evidence that there may exist regional markets for conventional wire fencing products and fence posts, but considers that the competition implications in the present application would be the same under both a narrow and broad market definition, given the minimal aggregation that would arise under the proposed acquisition.[21] Hence, in order to simplify the analysis for the purposes of the present application, the Commission will adopt a national market for the manufacture and wholesale supply of conventional wire fencing products and fence posts.

Gates & Gate Hardware

222. Industry participants have informed the Commission that resellers located in the South Island have historically paid approximately [ ] more for gates and gate hardware than resellers located in the North Island.[22] The Commission considers that if resellers had sufficient incentive to eliminate this price differential, and were unconstrained in doing so (by significant transport costs or other commercial restrictions), then they would have done so already by shifting

[21] A discussion of the level of aggregation is set out in the competition analysis.
[22] The Commission understands that [ ], but believes that pricing remains predominantly regional at the present time.

demand to the region that offers the most favourable pricing. However, the Commission has found no evidence of such switching taking place to date.

223. [ ], advised the Commission that there are a number of reasons why resellers have not historically sourced gates and gate hardware outside their immediate regions. Firstly, gates are bulky items that require a large amount of cubic space when being transported. Secondly, gates tend to damage easily while being transported so by arranging freight themselves, resellers expose themselves to the risk of receiving damaged stock without a manufacturer's replacement guarantee. Finally, gate hardware is typically quite heavy to freight. As a result of all these factors, freighting gates and gate hardware between the North and South Islands would likely prove uneconomic for resellers. This led the Commission to the conclusion that there are two separate geographic markets for the manufacture and wholesale supply of gates and gate hardware – one in the North Island and one in the South.

Animal Weighing Systems

224. Resellers also expressed a general view that national pricing existed for animal weighing systems. The fact that resellers face geographically uniform prices suggests the existence of a national market since suppliers have strong incentives to regionally price (to build in to the price the cost of transport to distant locations) wherever it is feasible for them to do so. National pricing suggests that suppliers are somehow constrained in pricing regionally.

225. Resellers advised the Commission that because the per-unit wholesale (and retail) price of animal weighing systems is typically quite high, relative to freight costs, sourcing product from other geographical locations within New Zealand in the face of a local SSNIP of five to ten percent would likely be profitable, depending on the quantity of stock being purchased and freighted.[23] Furthermore, resellers contended that because animal weighing systems is "reasonably compact", there would be economies in transport. On this basis, the Commission concludes that the market for the manufacture and wholesale supply of animal weighing equipment is a national one.

Conclusion on Market Definition

226. The Commission concludes that the relevant markets for the purpose of analysing the proposed acquisition are:

- the national market for the manufacture and wholesale supply of rural and security electric fencing products (the electric fencing market);
- the national market for the manufacture and wholesale supply of rural conventional wire fencing products (the conventional wire products market);
- the national market for the manufacture and wholesale supply of rural fence posts (the fence posts market);
- the North Island market for the manufacture and wholesale supply of rural gates and gate hardware (the North Island gates market);

[23] Freight is typically a fixed cost since resellers pay a fixed amount for the use of a freight container. As the quantity of inventory per container load increases, the lower the per unit fixed cost of freight. Hence, by forecasting stock needs and purchasing infrequently (to economise on container capacity), resellers could increase the feasibility of sourcing product across a wide geographic area. [ ].

- the South Island market for the manufacture and wholesale supply of rural gates and gate hardware (the South Island gates market); and
- the national market for the manufacture and wholesale supply of animal weighing systems and accessories (the animal weighing systems market).

COUNTERFACTUAL AND FACTUAL

227. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[24] The difference in competition between these two scenarios which can be attributed to the impact of the acquisition, establishes if there is likely to be a substantial lessening in competition.

Factual

228. In the factual, the PEL brand would be divested and operate as a separate competitor to the combined entity in the electric fencing market. Post acquisition the combined entity would be by far the largest supplier of rural electric fencing products, and the only supplier of security electric fencing products in New Zealand. The combined entity would also operate in a number of other agricultural markets including, conventional wire fencing products, gates and gate hardware, posts and animal weighing systems.

229. In assessing what the factual will be and the role PEL would play in the market post acquisition and therefore what weight the Commission can put on the divestment in the factual, the Commission has considered whether the divestment of PEL would be practical and viable.

Practicality and Viability of Divestment

230. The Applicant submitted that PEL is likely to be the most practical Tru-Test brand to divest since:

> …this brand has been the most recent electric fencing acquisition by Tru-Test and as such is likely to have the least product integration with other Tru-Test products and the least brand association with Tru-Test. For example, the Speedrite and Stafix product range have very high levels of shared internal energiser workings.

231. The Commission notes two points in relation to this statement. First, the Commission encountered a high level of awareness amongst resellers of PEL's ownership by Tru-Test. All resellers the Commission consulted (including those who do not stock PEL products) strongly associated the PEL brand with Tru-Test.

232. Secondly, although PEL is the most recent electric fencing brand to be acquired by Tru-Test, this acquisition took place three years ago (2001). The Commission notes that in the three year period since the acquisition, Tru-Test

[24] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts Ltd/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

has rationalised the plant, equipment, and manufacturing processes of PEL to much the same level as its Stafix and Speedrite operations.

233. This is borne out by Tru-Test's submission that:

> …there is no separate business called 'PEL' able to be divested as a going concern. PEL is fully integrated with Tru-Test's other electric fencing brands. All that could be divested pursuant to {Gallagher's} undertaking is the brand and some old tools and dies.

234. On a site visit, Commission staff saw evidence of a high level of integration while inspecting Tru-Test's manufacturing plant. In particular, [ ]. Similarly, [ ]. Commission staff also observed that [ ].[25]

235. The Applicant has suggested that, notwithstanding the level of integration (and therefore potential issues as to the practicality of a divestment) of PEL's manufacturing assets into the Tru-Test business, a potential buyer could readily outsource production of accessories, electronics, and plastic moulding from a number of independent contract manufacturing firms.

236. The Commission agrees that there is scope to outsource production of some componentry. Examples of large electronics contract manufacturers in New Zealand include GPC Electronics (GPC), Prolificx Electronic Solutions, and iTouch – all of which offer supply chain planning, design for manufacture, manufacturing, testing, and technical support services.

237. Frank Owen, CEO, GPC informed the Commission that electronic contract manufacturers such as GPC could easily contract manufacture energisers for a potential buyer of PEL, provided the buyer could make available technical drawings and component requirements. Frank Owen further advised that the use of contract manufacturers (as opposed to in-house manufacturing) could even create cost savings for small buyers since contract manufacturers often enjoy economies of scale in production, superior buying power for components and other inputs (since materials are often purchased in bulk for a number of different contracts), and can spread project risks across independent contracts (liability reduction).

238. Robin Martin, CEO, Plastics New Zealand advised the Commission that given access to existing PEL tooling, a number of custom injection moulding firms could easily contract manufacture plastic products for a potential buyer of PEL, in the event the buyer did not have in-house plastic moulding capability. Some large specialist plastic contract manufacturers in New Zealand include Adept Ltd., Talbot Plastics Ltd., and Viscount Plastics Ltd. All these contract manufacturers also offer advice on application-specific choice of raw materials, sourcing of materials, and new mould design services.

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[25] [

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239. Similarly, Paul Winter, CEO, Employers and Manufacturers Association (Central), advised the Commission that several mechanical engineering firms who actively compete for manufacturing contracts could readily produce accessory products, such as pigtail standards and strainers, for a potential buyer of PEL, if this buyer lacked the wherewithal to do so themselves. Such manufacturers would only require technical drawings and specification of production materials in order to carry out this contract manufacturing work. Examples of such engineering firms include A.E. Tilley Ltd., Fitzroy Engineering Ltd., and Windsor Engineering Group Ltd.

240. The Commission considers that even though PEL has been heavily integrated into Tru-Test's production lines, it could still be practical for a new owner of PEL to outsource PEL's manufacturing. However, the Commission notes that clause 3.3 in the divestment undertaking raises potential issues and therefore casts doubt, as to whether in fact the divestment of PEL would be practical.

241. Clause 3 of the divestment (as amended by Gallagher's letter dated 10 August, 2004 to the Commission) defines the PEL business assets to be divested.

242. Sub clause 3.3 includes any plant and equipment (e.g., injection moulding tools and test jigs) required to allow sub contract manufacture, but provides for the substitution of "a similar but alternative product" "in the event that the plant and equipment …is necessary for the manufacture of any other Tru-Test product worldwide branded other than PEL, at the time that Gallagher declares any offer to all shareholders of Tru-Test to be unconditional".

243. The Commission understands from Tru-Test that PEL's icon products are also being used in the Stafix and Speedrite product ranges. A number of industry participants have advised the Commission that clause 3.3 is in effect a "cherry picking clause", which could allow the combined entity to keep certain PEL icon products such as the PEL [ ][26] For example, in respect of clause 3.3, [ ] stated:

[

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244. Tru-Test advised the Commission that PEL's [ ] product represents [ ]% of PEL's overall sales. [ ]:

[

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245. [

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246. The Applicant submitted to the Commission that clause 3 was intended to protect against Tru-Test frustrating the acquisition process. Steve Tucker, Gallagher stated:

[26] The seven icon products listed by Tru-Test are [

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> A key reason for including this substitution in the undertaking is to prevent frustration from Tru-Test in the event this Application is successful. Tru-Test would be in a position to substitute or remove products from the PEL range after the date of the Application and before any takeover offer was declared unconditional in an effort to the frustrate the process.

247. The Commission appreciates that Gallagher may have concerns, and would not wish to enter into a form of undertaking that it would not be certain it could honour. Nonetheless, the Commission considers that clause 3 could have the following effects:

- the absence of key PEL products could de-value the PEL range and therefore make PEL unattractive to a potential buyer;
- the products allocated to the new owner of PEL could be of an inferior quality, or lack the market presence of the PEL key products. Without exception, rural resellers advised the Commission that they would therefore be unwilling to support the new owner of PEL if the PEL range did not include these icon PEL products; and

248. [

], thereby lessening the constraint PEL could place on the combined entity post acquisition.

249. As noted above, clause 3.3 of the Divestment Undertaking may be interpreted as meaning that if plant and equipment acquired by Gallagher is also required for the production of Stafix or Speedrite products, then Gallagher reserves the right to keep such equipment and allocate the buyer of PEL alternative plant and equipment to produce a similar but different product.

250. There is also scope for the combined entity to use clause 3 to keep icon PEL products and therefore weaken the PEL brand upon divestment. The Commission also notes that, as proposed, the divestment undertaking would allow the Applicant up to 12 months to establish a combined position in the market place before being required to complete the disposal of the PEL assets to that party amongst the potential purchasers most to its choosing.

251. The Commission further notes that it requires, as a matter of policy, to have a reasonable degree of certainty as to the nature and scope of the subject matter of a divestment in order to be able to properly consider whether to accept it or not. As clause 3.3 potentially allows the combined entity to substitute plant and equipment, the Commission cannot be certain as to the actual detail of the divestment undertaking. With such uncertainty created, the Commission cannot properly analyse the divestment of PEL and whether it would be the competitive influence the Applicant claims.

252. In order to act as an effective competitive constraint to the combined entity post-acquisition, it is necessary that the divested PEL business be a viable enterprise post-acquisition. The Commission notes that there are potential purchasers of the PEL brand who have advised the Commission that they would be active bidders for the assets should the opportunity arise. The Commission notes,

however, that potential buyers have not undertaken due diligence on the PEL brand in order to access its financial position. [

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253. The Commission has therefore assessed the viability of PEL as a stand-alone business.[27] For this purpose a standard Discounted Cash Flow (DCF) approach was used in order to calculate the Net Present Value (NPV) of the stand-alone enterprise over a ten year horizon.[28] In doing so, a model was run under a base-case scenario that employed a set of underlying assumptions. Sensitivity analysis was then performed on the model by relaxing a number of key assumptions in turn. These departures from the base-case scenario allowed the Commission to assess the effect of varying uncertain risk factors and other exogenous variables on the viability of the PEL brand.

254. [

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255. [ ] of PEL, it would be possible for the Commission to not give any weight in its competition analysis to the PEL divestment. However, the Commission will, for completeness, assume the factual includes the successful divestment of PEL. The Commission notes that if there is a substantial lessening of competition with PEL as a viable divestment, a substantial lessening of competition would also eventuate if PEL was not a viable divestment.

256. For the purposes of the factual therefore, the Commission has assumed PEL to be a viable competitor to the combined entity in the electric fencing market.

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[27] [

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[28] A Net Present Value of zero implies that if the purchaser of PEL pays nothing for the assets and receives the cash flows projected, they will earn exactly the (assumed) required rate of return for the business. Hence, the NPV of the project represents the maximum a rational purchaser would be willing to pay for the PEL brand given the assumed rate of return.

Counterfactual

257. Tru-Test is not currently for sale and the Applicant acknowledges that this is a hostile takeover. The Applicant has submitted that it is concerned with the on-going profitability and viability of Tru-Test. Specifically it states:

> The financial performance of Tru-Test has deteriorated to a level where the ongoing viability of Tru-Test is questionable (refer 10.6-10.7 of the Application). During this same period the financial performance of the Gallagher Group has strengthened [29]

258. Tru-Test refuted the Applicant's claim and submitted:

> The competition is fierce between Tru-Test and {Gallagher}. {Gallagher} has had the longest time in the market and Tru-Test has had to be innovative and aggressive in product development and service so as to take market share. Both have had successes and failures in their business with the rural resellers. Contrary to what {Gallagher} asserts in the Application, however, Tru-Test has had more successes than failures and consistently grown its market share at the expense of {Gallagher} over the last five years (we repeat what we told you at our meeting, as set out in the appendix attached to this letter, that the figures put forward by {Gallagher} at paragraphs 10.6 and 10.7 are wrong). [30]

259. The Commission has found no evidence that Tru-Test could not continue to operate as an effective competitor to Gallagher in the counterfactual. Tru-Test and Gallagher are currently engaged in fierce competition where large rural reseller accounts are won and lost by both firms.

260. The Commission therefore considers that the appropriate counterfactual is the status quo.

COMPETITION ANALYSIS

The Electric Fencing Market

Existing Competition

261. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors). Supply-side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

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[29] Gallagher state in 10.6 and 10.7 as follows:

> Gallagher is concerned about the ongoing profitability and viability of Tru-Test. For the 5 year period 1998 to 2002 Tru-Test delivered an audited average annual after tax surplus attributable to shareholders of $878,800 (source – Tru-Test Investment Statement and Prospectus 9 May 2003, p.14). The net surplus for the 2003 year was $2.439M, but included a net increase of capitalised development costs of $2.298M in that same year (source Tru-Test annual accounts 31 August 2003).
>
> Both Tru-Test and Gallagher continue to face a difficult global trading environment with high exchange rates and generally weaker rural trading markets. Tru-Test has reported to shareholders a 2004 half-year deficit of $502,000, excluding non-recurring items.

[30] [

262. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

263. The Commission identifies market shares for all significant participants in the relevant market. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used.

264. An aggregation that would result in a low concentration level is unlikely to be associated with a substantial lessening of competition in a market. On this basis, indicative safe harbours may be specified.

265. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of a 40% share; or
- where the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

266. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market. Specifically, the Commission seeks to understand the dynamics of the competition that would exist between the remaining firms in the market, compared to what would exist in the absence of the merger.

267. The following competition analysis discusses all aspects of existing competition in the market for electric fencing including market shares and existing market conditions.

268. The Commission considers the appropriate measure to determine market share in this market is the revenue earned from the sales of the products represented in the electric fencing market. Table 2 below sets out the estimated market shares of the combined entity and other competitors in the electric fencing market based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

Table 2: Market Shares for the Electric Fencing Market 2003 [31]

Company	2003 ($)	Market share (%)
Gallagher	[ ]	[ ]
Tru-Test	[ ]	[ ]
COMBINED ENTITY	**[ ]**	**[ ]**
PEL	[ ]	[ ]
Others	[ ]	[ ]
TOTAL	**[ ]**	**100**

269. Post acquisition, the combined entity would have a combined market share of [ ]%. The current three firm concentration ratio prior to the divestment of the PEL brand is [ ]%.[32] Post acquisition the three firm concentration ratio would be [ ]%. The market shares in the electric fencing market, post acquisition, would be outside the Commission's safe harbours guidelines.

270. The Commission notes that security electric fencing products make up only [ ]% of the total market for electric fencing. Table 3 illustrates the market shares for security electric fencing products.

Table 3: Segment Shares for Security Electric Fencing Products 2003

Company	2003 ($)	Segment share (%)
Gallagher	[ ]	[ ]
Tru-Test	[ ]	[ ]
COMBINED ENTITY	**[ ]**	**100**
TOTAL	**[ ]**	**100**

271. Tru-Test advised the Commission that Gallagher and Tru-Test are the only suppliers of industrial security electric fencing products. Tru-Test submitted that there would be a significant loss of competition in this sector of the electric fencing market.

272. [

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273. Post acquisition, there would be no alternative supplier of security electric fencing products to the combined entity in New Zealand that could impose a

[31] The market share figures are based on Gallagher's year end of 30 June 2003 and Tru-Test's year end 30 August 2003. The Commission notes that O'Brien is now active in the electric fencing market and as at June 2004 had sold approximately $[ ] worth of electric fencing accessories.
[32] The next largest competitor is Robertson Engineering with [ ]% market share.

potential supply-side constraint on the rural electric fencing segment of the market. Suppliers of rural electric fencing products other than the combined entity could constrain the security electric fencing segment via supply-side switching. However, the Commission notes that none of the existing rural competitors has ever developed or supplied electric security fencing products. Further, as discussed later in the Barriers to Expansion section of this Decision, the Commission considers that it could be problematic to import electric fencing products. The Commission considers it unlikely that the existing rural segment of the electric fencing market would switch into the security fencing segment and restore competition to its pre-merger levels.

274. The Commission concludes that compared with the counterfactual where there are two strong competitors, the acquisition would result in a significant loss of existing competition in respect of security electric fencing products.

275. In the supply of electric fencing products, rural electric fencing products represent [ ]% of the market. Accordingly, the Commission's analysis in terms of existing competition will substantially focus on this segment of the electric fencing market as this will capture the substantive competition issues that arise from the proposed acquisition.

276. Table 4 illustrates the brand shares for rural electric fencing products.

Table 4: Brand Segment Shares for Rural Electric Fencing Products 2003 & 2004[33]

Brand	2003 ($)	Segment Share (%)	2004($)	Segment share (%)
Gallagher	[ ]	[ ]	[ ]	[ ]
Franklin [34]	[ ]	[ ]	[ ]	[ ]
Speedrite	[ ]	[ ]	[ ]	[ ]
-Stafix	[ ]	[ ]	[ ]	[ ]
COMBINED ENTITY	**[ ]**	**[ ]**	**[ ]**	**[ ]**
PEL	[ ]	[ ]	[ ]	[ ]
Others	[ ]	[ ]	[ ]	[ ]
TOTAL	**[ ]**	**100**	**[ ]**	**100**

277. The Commission recognises that the proposed acquisition alters the market structure from two effective and equally matched players to a large player with [ ]% and a small competitor, PEL, with [ ]% in respect of rural electric fencing products.

278. The Commission has assessed the state of current competition between Gallagher and Tru-Test in terms of shelf space, price, product range and innovation in respect of rural electric fencing products.

[33] The 2004 figures from Tru-Test are based on 11 months to July with August forecasted.
[34] Gallagher introduced the Franklin range of electric fencing products as a house brand supplied to Farmlands only in January 2004. Gallagher expects Franklin's sales to Farmlands to be approximately $[ ] for the 12 months ending December 2004.

Shelf space, price and product range

279. The Commission found that Gallagher and Tru-Test actively compete for shelf space in rural resellers. Both companies compete on price, quality of service, and product range. The Commission found that Gallagher and Tru-Test had recently won and lost substantial accounts with rural resellers. The notable examples are discussed below.

280. Prior to October 2003 Farmlands stocked both Gallagher and Tru-Test electric fencing products. Gallagher accounted for approximately two thirds of Farmland's shelf space while Tru-Test accounted for approximately one third. On 1 October 2003, Gallagher became Farmland's preferred supplier through The Farmlands / Gallagher Partnership Agreement. (The Farmlands Agreement). [

] Tru-Test estimates that the loss of the Farmland account has resulted in an annual net loss in revenue of approximately $[ ]

281. Williams & Kettle traditionally stocked Gallagher branded electric fencing products and routinely allocated approximately [ ]% of its shelf space to Gallagher electric fencing products. The remaining shelf space was being allocated to Tru-Test. [

] The net loss in revenue to Gallagher was estimated to be approximately $[ ] annually.

282. In 2000, Wrightson placed its electric fencing category up for tender. [

] Tru-Test estimates that it has gained approximately $[ ] annually from securing Wrightson's business.

283. Taranaki Farmers stocks both Gallagher and Tru-Test electric fence products. Gallagher and Tru-Test share approximately [ ]% of its shelf space for electric fencing products. [

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284. The Commission considers that there is strong evidence of fierce competition between Gallagher and Tru-Test. This fierce competition is evidenced by both companies' active use of rebates, service, product range and house brands as a means of enticing large rural resellers to switch suppliers.

285. A number of rural resellers expressed concern that the current competitive tension would be lost post acquisition. For instance, [ ] advised the Commission that he was extremely concerned that post acquisition, the competition between Gallagher and Tru-Test, which he described as "fierce", would be lost. [ ] stated:

> They would be the two fiercest competitors out of any industry that I deal with right across the agricultural range.

Innovation

286. There is evidence that Gallagher and Tru-Test compete with new product lines, particularly in respect of high-joule energisers. For example, Tru-Test released the M36/3000 range in 1999 to compete with Gallagher's MX5000 series. In 2001, Tru-Test added a remote control system to its range. Similarly, Gallagher has recently launched the "Select" range of high-joule energisers that are designed to compete with Tru-Test's high-joule energisers.

287. Some rural resellers have expressed concern that post acquisition, the combined entity would have less incentive to innovate in respect of electric fencing products. For example, [ ], advised the Commission that [ ] was concerned that the combined entity would lack the incentive to innovate that currently exists with competition between the two firms.

288. Nonetheless, Gallagher and Tru-Test export approximately [ ]% of their electric fencing output. As such, it is likely that the combined entity would continue to innovate in order to remain competitive in their respective overseas markets.

289. However, there may be less incentive for the combined entity to innovate in respect of high-joule energisers. This is because there is less demand for high-joule energisers in the overseas markets due to different farming conditions and safety standards associated with having high-joule energisers.

290. As discussed earlier, approximately [ ]% of purchases of electric fencing products are for maintenance or replacement of equipment. The Commission is therefore of the view that innovation could be necessary to encourage existing users of electric fencing to upgrade and/or replace existing electric fencing systems.

291. On balance, the Commission considers that there is some scope for the combined entity to reduce its innovation in respect of high-joule energisers, but in small joule energisers, innovation is likely to be maintained due to the requirements of overseas markets.

PEL

292. Gallagher states in its amended Application that the combination of a new owner of PEL and other existing suppliers would provide sufficient constraint on the combined entity.

293. A number of resellers expressed concern that a significant loss of competition would result, post acquisition, notwithstanding the divestment of PEL. Many resellers advised the Commission that their concerns in respect of the loss of competition had not substantially altered in considering PEL as a competitor. For example, [ ] advised the Commission that the divestment of PEL "would not change a huge amount as they are divesting the weakest brand".

294. [

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295. While the Commission notes that the divestment of PEL reduces the combined entity's market share in respect of rural electric fencing products from [ ]% to [ ]%, the proposed acquisition nevertheless still results in a very significant loss of existing competition. [

] further undermines its ability to act as an effective constraint on the combined entity post acquisition.

296. In the counterfactual, Gallagher and Tru-Test would remain two equally matched competitors that would continue to fiercely compete in terms of price and innovation. PEL is unlikely to restore such fierce competition evident in the counterfactual due to its small and [ ] market share as well as its [ ]

Other Existing Competitors

297. Post acquisition, the remaining existing competitors will together account for [ ]% of the electric fencing market. They have no presence in the security electric fencing segment of the market and [ ]% in respect of rural electric fencing. Due to their small market shares, the Commission considers that small existing competitors are unlikely to prevent the combined entity from raising prices or reducing quality post acquisition.

Overall Conclusion on Existing Competition

298. The Commission considered whether there would be sufficient and likely constraint from a new owner of PEL or fringe competitors in the factual to prevent the combined entity from raising prices or reducing the quality of its service.

299. In the electric fencing market, the combined entity would have [ ]% market share. In the supply of security electric fencing, the combined entity would have a market share of 100% while in the supply of rural electric fencing products the combined entity would have a market share of [ ]%. The loss of competition between Gallagher and Tru-Test is considered to be very significant, particularly as there is currently strong competitive tension between them. This very significant loss of existing competition evident in the counterfactual is unlikely to be restored by the divestment of the PEL brand or by the activities of fringe competitors.

300. The Commission concludes that the proposed acquisition is likely to lead to a very significant reduction in existing competition. The Commission must therefore consider whether potential competition is sufficient to prevent a substantial lessening of competition in the electric fencing market.

Potential Competition

301. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market expansion or entry.

302. The Commission's focus is on whether businesses would be able or would be likely to be able to expand, or enter the market and thereafter expand should they be given an inducement to do so, and the extent of any barriers they might encounter should they try. Where barriers to entry and expansion in a market are clearly low, it may be unnecessary for the Commission to identify specific businesses that might enter. In other markets, where barriers are higher, the Commission may seek to identify possible new entrants as a way of testing the assessed entry and expansion barriers.

Barriers to Entry and Expansion

303. The likely effectiveness of the threat of new entry and expansion in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market. The Commission is of the view that a barrier to entry is best defined as anything that amounts to a cost or disadvantage that a business has to face to enter a market that an established incumbent does not face.

304. The Commission will consider potential competition in respect of:

- Expansion by existing competitors; and
- New entry.

Expansion by Existing Competitors

305. Post acquisition, and following divestment, PEL would be the largest competitor with [ ]% of the rural electric fencing products segment. The remaining five competitors would represent [ ]% of the electric fencing market. The Applicant submits that PEL and the other small existing competitors could easily expand to provide a sufficient constraint on the combined entity post acquisition.

306. The potential barriers to expansion that could be faced by existing competitors in the electric fencing market are discussed below. The Commission has found that a number of barriers to expansion are present.

Access to Resellers

307. The Applicant agrees that a barrier to entry or expansion in respect of the electric fencing market has historically been the ability of small players to gain access to rural resellers. However, the Applicant considers that post acquisition, the rural reseller will have a stronger desire and incentive to increase access to distribution to act as a constraint on the activity of the merged entity.

308. The Commission notes that there has been little expansion by existing competitors in the last five years. Artex, which distributes Zareba branded products has gained very limited access to any of the eight large rural resellers. Similarly, Taragate has achieved only limited access into the eight large rural resellers through niche electric fencing accessories.

309. [

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310. The Commission agrees that post acquisition there would be some incentive for the large rural resellers to support the entry and expansion of existing competitors. However, the Commission has spoken with the existing competitors and the large rural resellers and, on the basis of that information, considers that notwithstanding this incentive, post acquisition, access to resellers would remain a significant barrier to entry and expansion.

311. Rural resellers, such as [ ], advised the Commission that an existing supplier could only gain access to their stores, if they had:

- an established brand and reputation;
- an extensive infrastructure in terms of sales, marketing and technical support;
- a complete product range including low joule battery energisers through to a high-joule mains energiser; and
- the ability to bundle products and offer competitive rebates.

Brand & Reputation

312. Gallagher currently sells its Gallagher branded electric fencing range throughout New Zealand and has a substantial presence in most large rural resellers. It has recently introduced the "Franklin" electric fence brand into Farmlands stores. Similarly, Tru-Test also has a substantial presence in most of the large rural resellers.

313. Most of the large rural resellers stock very little product supplied by small competitors in the market. For example, Farmlands stocks some Taragate products. The rural resellers advised the Commission that these products tend to be niche products that are not supplied by Gallagher or Tru-Test.

314. In general, establishing a brand, and particularly supporting it, is crucial to gaining access to shelf space in retailers. Retailers also evaluate the extent of the marketing campaign supporting a new brand before they give any shelf space. This leads to a potentially paradoxical situation: to enter the market at a level sufficient to act as a constraint requires access to resellers. That in turn requires shelf space with the prospect that the product will sell before such shelf space is made available. To be sure that the product will sell requires a brand that is recognised and in demand. But a brand that is recognised and in demand requires not just advertising, but also availability, which requires shelf space.[35]

315. The Applicant submitted that "electric fencing is relatively undifferentiated and as such brand and reputation are not a significant barrier."

316. While it appears that brand is important to some extent, the Commission consulted a number of users (farmers) who advised that they tend to purchase whatever electric fencing products is stocked by their favoured rural reseller. This is because they consider that their rural reseller is unlikely to stock inferior or low quality products.

[35] Decision 459 National Foods Ltd & New Zealand Dairy Foods Ltd, 22 March 2002 at page 35.

317. The purchasing habits of farmers as discussed above is reinforced by the Marketing Eye Survey conducted by Gallagher in April 2002 which concluded that customers are generally price driven. In particular the survey found:

- [ ]% of customers who purchased energisers purchased what ever their rural reseller had to offer, with [ ]% of those indicating their rural reseller had a lot or some influence on their brand selection; and
- [ ]% of customers would not automatically chose a brand and would look at other energiser options if they were to purchase in the future.

318. While the Market Eye Survey concludes that customers are price driven and that brand is less important, it should also be noted that the Market Eye Survey found that [ ]% are brand conscious. This is a significant proportion of users. The Commission also found some evidence of brand loyalty amongst farmers. For example, [

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319. The Commission spoke with some farmers who advised that for a large capital purchase like an energiser, they would be more likely to "shop around". Conversely, if they were purchasing accessories, they were more likely to buy from their favoured reseller.

320. On balance, the Commission considers that from the point-of-view of users, brand preference is likely to play at least some part in their purchasing decision, but is unlikely to be the deciding factor. Rather, the customer will tend to purchase what is available in their rural reseller and, if the survey is correct, also have regard to price.

321. The Commission notes, however, that rural resellers have informed the Commission that it is easier to sell an established brand. Accordingly, in deciding to stock more of an existing competitor's product, resellers need to be sure that the new product has at least some brand profile or that the existing competitor has a comprehensive marketing plan in place that will support the new products. Typically, rural resellers require a promotional and advertising support, normally between [ ]% of total sales annually.

322. [

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[

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323. This is illustrative of the extent of marketing support some resellers expect of their suppliers.

324. Some rural resellers also advised the Commission that as well as an established brand, reputation was an important factor, along with others, in considering whether to support the expansion of an existing competitor. [ ], stated that he considered reputation was a factor when considering stocking a

new product. [ ], noted that it could be the rural reseller's reputation at stake if it supported expansion by an unproven small existing competitor if the new products proved to be faulty or of an inferior quality.

325. [

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326. [ ], informed the Commission that brand and reputation were factors in obtaining shelf space with rural resellers. [ ] stated that without a range of good quality energisers it could take over five years for a brand to be accepted by rural resellers.

327. On the other hand, some rural resellers recognised that while brand and reputation were important, their customers were likely to place a great deal of trust in the judgement of their rural resellers. This was especially emphasised by [ ]. Accordingly, their customers would purchase whatever product was in their stores, trusting that only high quality merchandise would be stocked.

328. On balance, the Commission considers that establishing brand recognition and a reputation that could be acceptable to the large rural resellers is likely to represent a moderate barrier to expansion for existing competitors.

Infrastructure

329. Currently, the fringe players have limited infrastructure compared to that of Gallagher and Tru-Test. This reflects the fact that they have not been able to secure any meaningful access to the large rural resellers and, as a result, do not have extensive infrastructures.

330. The large rural resellers advised the Commission that an existing supplier must be able to demonstrate an extensive infrastructure in terms of in-store sales support and technical back-up in respect of maintenance and repairs. [ ], advised that technical back-up and the ability to quickly repair faulty products would be crucial to [ ] supporting expansion from an existing small player.

331. The Commission has been informed by some rural resellers that there is considerable doubt as to whether any of the existing competitors could offer suitable infrastructure to meet their specific support needs.

332. The Applicant states that "the sales and technical infrastructure required is a factor of, and can be self funded by, the extent of distribution given to the competitor by the rural reseller."

333. The Commission notes that as an existing competitor grows, it will naturally expand its infrastructure to support any new customers. However, in order for a small existing competitor to persuade the large rural resellers to offer it greater access to their stores, it needs to demonstrate a robust infrastructure in order to gain that resellers support in the first instance. In some cases, for example, RD1 and Wrightson, this would require national coverage.

334. The Applicant advised the Commission that it has [ ] sales and support staff who cover the whole of New Zealand. Gallagher estimates that this amounts to an annual cost of approximately $[ ]. Gallagher has [ ] staff assigned to repair and maintenance of its electric fencing products which represents an annual cost of approximately $[ ].

335. The Commission notes that many fringe players or new entrant's required investment in infrastructure would be disproportionate to its expected sales. Accordingly, establishing a credible distribution network could be a significant barrier to entry or expansion. On the other hand, some existing competitors, notably Hurricane, already have such distribution networks in place for other products and would be unlikely to face this hurdle.

336. The Commission considers that new entrants and existing competitors would need to demonstrate, at a minimum, to resellers they have a robust support structure in place. The Commission considers that this would require at least a moderate to high initial investment on the part of the new entrant or existing competitor which could in many cases be disproportionate to expected sales. This initial investment in infrastructure is a cost not faced by the incumbent (the combined entity) at the time of entry or expansion, so accordingly, the Commission considers that establishing a robust infrastructure is likely to represent a moderate to high barrier to entry or expansion.

Product Range

337. The large rural resellers advised the Commission that in order to support expansion of a small existing supplier, the existing supplier must be able to supply a full range of electric fencing products. This includes accessories, such as pigtail standards, through to a full range of energisers.

338. [ ], advised the Commission that [ ] would require a full product range and that her concern was that the amount of products that the small existing competitor's could offer would be "limited". Similarly, [ ], advised the Commission that the small fringe competitors would have to offer a full product range with "comparable product specifications and performance".

[

]

339. The Commission notes that there is some evidence that suggests customers do not use the same brand when purchasing electric fencing components. However, there is evidence that suggests resellers themselves require a complete product range. Due to the competitive nature of the rural retail market, it is desirable for resellers to carry a complete range to ensure their customers have a complete product range to choose from. Further, resellers also achieve lower

transaction costs by sourcing from a single supplier with a complete product range.[36]

340. The Commission understands that it is relatively easy for an existing supplier to expand its range in respect of electric fencing accessories. Indeed, existing suppliers such as Taragate and Robertson Engineering manufacture some of these accessories. Further, the generic nature of electric fencing accessories indicates that it could be expedient to arrange a contract manufacturer to produce the accessories.

341. However, an existing supplier would also need to provide a range of energisers in order to supply a complete range of electric fencing products to satisfy a large rural reseller. The Commission notes that the Applicant currently has 20 models in its energiser range in New Zealand. [ ], advised the Commission that a range of energisers is likely to need to include the following:[37]

- 0.1 joule battery strip grazer energiser;
- 1 joule battery strip grazer energiser;
- 5 joule mains energiser;
- 10-20 joule mains energiser; and
- 36 joule mains energiser.

342. Post acquisition, the combined entity would be the only supplier of a full range of energisers.[38] Existing suppliers would have to either develop their own range of energisers in house or out-source energisers from overseas manufacturers.

343. The Commission found that while there is scope to import some low joule energisers from overseas, existing suppliers looking to expand may encounter difficulty in sourcing high-joule energisers from overseas suppliers. The Commission also found that overseas energisers, whether they were low or high-joule, could face marketing issues in New Zealand due to a perception of inferior quality. These issues are discussed in greater detail below.

Sourcing from Overseas

344. Industry participants submitted to the Commission that the demands of New Zealand users are unlikely to be met by overseas suppliers – particularly with respect to high-powered energisers as the needs of overseas farmers appear to be different to those of New Zealand farmers. Furthermore, given that New Zealand is a relatively small and geographically isolated market for many of these overseas firms, there would be little incentive for them to develop a product exclusively to supply into New Zealand to meet these differing needs.

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[36] These cost savings could arise through more streamlined ordering and billing systems, the need to deal with only one account manager on a day-to-day basis, meeting minimum freight-paid quantities, and economies of transport.

[37] Steve Tucker, Gallagher, also advised the Commission that a range of energisers would include as aforementioned.

[38] O'Brien [

].

345. Rural resellers also expressed a general view that they would be extremely wary of importing an overseas range of electric fencing energisers due to a perceived lack of quality and technology compared to New Zealand brands. The Commission assessed the possibility of importing overseas manufactured energisers from two standpoints:

- The extent to which overseas market conditions may vary to that of New Zealand making the supply of their products into the New Zealand infeasible; and
- The extent to which market participants in New Zealand would accept overseas brands.

346. The Applicant advised the Commission that:

> Gallagher accept that offshore product range may not be complete in high-end energisers (e.g., greater than 30 Joules). However, this represents only approximately [ ]% of the energiser market or approximately [ ]% of the total electric fencing market (by value) in New Zealand

347. However, Tru-Test submitted that:

> Imported products are unable to compete effectively in the New Zealand market, as they are not well suited to the large fence sizes typical on New Zealand farms…
>
> … Medium and large energisers are an important part of the domestic market. Foreign competitors do not offer a product in these segments of the market, nor are they ever likely to. U.S. and European producers make products which suit the majority of agrarian applications in their various jurisdictions. Typically farm practices involve concentrated land-use, and bringing feed to the animals rather than open grazing over relatively large paddocks (as in New Zealand). Hence, low power energisers are suitable for most applications, and there is no incentive for a U.S. or European manufacturer to develop a medium or large energiser just for the New Zealand (or Australian) market. In fact, European manufacturers are currently attempting to have anything other than small energisers banned world-wide under international safety rules…
>
> … Remote control of energiser output (via fence wire signal) is another very popular feature in the {New Zealand} market, but not something which is as highly valued in U.S. and European markets given their more intensive farming practices. The only effective reliable remote control systems known are patented and owned by Tru-Test and {Gallagher} independently.[39]

348. The Commission has received a number of submissions that lend support to Tru-Test's statements that an overseas competitor has little incentive to supply the New Zealand market and develop a high-joule energiser. For example, [ ], stated in correspondence with the Commission:

> [
>
>].[40]

349. John Hoffman, Vice President, Sales, Zareba informed the Commission that "… there was no market for large energisers in the United States". As a result, the highest output energiser available in the United States is a 15 joule (output) energiser, and the bulk of Zareba's production was for a standard 1 joule

[39] Tru-Test Letter of Submission, 16 June 2004, pp. 5-6
[40] [

]

(output) energiser targeted at "hobby farms".[41] [
]

350. These statements recognise that the farming needs of New Zealand users of electric fencing products are quite different to those of users in other countries.

351. The Commission acknowledges large energisers are somewhat more prevalent in Australia. However, Thunderbird, which estimates it has approximately [ ]% market share in Australia, does not manufacture or supply a 36 joule energiser. Similarly, Daken does not manufacture or supply a 36 joule energiser [
]

352. The evidence before the Commission suggests that the use of high-powered energisers is uncommon in Europe and the United States. Industry participants informed the Commission that in Europe, farmers do not use high-joule energisers because they tend to grain feed their animals and keep them in small, and sometimes indoor, enclosures. European countries also have safety standards in place that recommend against the use of high-joule energisers.

353. In contrast, the use of high-power energisers is commonplace in New Zealand on medium to large-sized farms.

354. Given the limited demand for high-power energisers in foreign markets, overseas suppliers have historically had little incentive to develop such an energiser range.

355. In its inquiries, the Commission has encountered widespread opinion amongst rural resellers, existing competitors, potential entrants, and users that a brand of imported energisers would struggle to gain acceptance in New Zealand since New Zealand is a "mature market" with "sophisticated" users. Furthermore, the two major suppliers to this market, Gallagher and Tru-Test, are recognised in New Zealand and internationally as market leaders in the supply of energisers. The combination of these two factors could mean that rural resellers and users view any imported energisers as being inferior in quality. The resellers, in particular, would be unwilling to take the risk that the imported energisers might be inferior as it could damage the reseller's reputation in the eyes of its customers.

356. The rural resellers expressed a general view to the Commission that any potential suppliers of electric fencing would be required to have a "full range" of electric fencing products, which would include high-power energisers. In order for a near competitor to meet this criterion by outsourcing energisers from abroad, its overseas suppliers would be required to develop energisers in the high-power range.

357. However, industry participants considered that these imported energisers would gain little or no acceptance in New Zealand. For example, [ ], stated:

> We do believe that the New Zealand companies Tru-Test and Gallagher lead the world in electric fencing products development and technology and also believe that any imported brand would struggle to gain acceptance in the New Zealand market.

[41] It was submitted to the Commission by Zareba that owners of large commercial farms in the U.S. prefer to use barbed wire instead of electric fencing as the main form of livestock management.

358. [ ], an existing competitor, informed the Commission that an imported brand would have difficulty gaining acceptance with resellers, particularly given the strength and acceptance of existing New Zealand brands, citing the to-date poor uptake of Red Snap'r energisers with resellers and users as a case in point.

359. Potential entrants from abroad have also highlighted to the Commission the difficulties in their products gaining acceptance by local rural resellers and users. For instance, [ ], stated:

[

]

360. Users have also expressed concern about the quality of imported energisers. For example, [ ], dairy farmer, informed the Commission that he would be very wary of accepting an imported energiser due to concerns about quality.

361. The Commission recognises that these statements were made in an environment where Gallagher and Tru-Test – both leaders in producing energisers – acted as strong competitive constraints on one another, thus relieving the need to consider import options. Absent this competitive tension, rural resellers and users may be compelled to consider overseas energisers as an alternative to those supplied by the combined entity, despite their apparent concerns over the quality of imported energisers.

362. It is difficult, ex-ante, for the Commission to test the actual willingness of rural resellers and users to make such considerations. However, the Commission does take note of the widespread consensus between industry participants on expected poor uptake. Accordingly, the Commission acknowledges the anticipated unwillingness of rural resellers and users to accept imported energisers, under the factual.

363. The Commission considers that the difficulty in sourcing a complete product range, including high-joule energisers from overseas suppliers, together with quality concerns and the difficulty faced in marketing an overseas brand to the large rural resellers represents a significant barrier to expansion.

364. Due to the likely difficulties faced by small existing competitors in importing a range of energisers, the Commission discusses the capital costs of developing a range of energisers below.

In-House Development

365. An existing supplier may wish to develop its own range of electric fencing products. It appears relatively straightforward to source electric fencing accessories from an existing supplier or secure the services of a contract manufacturer to produce the accessories. However, a range of energisers would also need to be developed. The engineering expertise, capital costs and intellectual property associated with developing a range of energisers is discussed below.

Engineering Expertise

366. On the expertise required to carry out the necessary research and development in energisers to match the technology of competing brands, Des Scott, Managing Director, Tru-Test stated:

[

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367. Des Scott also stated:

[

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368. In response, the Applicant argued that any restraint of trade clauses would not create significant limitations to the mobility of expertise. John Horner, Quigg Partners (acting for the Applicant), posited that standard restraint of trade restrictions for senior engineers in New Zealand were unlikely to exceed a twelve month period.

369. The Applicant argued that in the event that some restraint of trade clauses did apply, energiser products are not so sophisticated that non-specialist engineers could not be utilised by a new entrant or existing competitor looking to expand. The Applicant suggested it that "any experienced {non-specialist} engineer with 10 years plus experience" could become familiar with the products and standards in the industry within a one to two month period at the most.

370. Peter Morphy, Principal Technical Advisor to the Energy Safety Service, Ministry of Economic Development advised the Commission that generally electrical engineers are not trained in the area of appliance technology, such as electric fencing. He noted that there "would be very few people in the world who are good at this {electric fencing} technology".

371. However, he noted that specialist electric fencing expertise was most likely to come from someone with knowledge of electrical engineering, electronics and wave form technology and that there was unlikely to be a shortage of these types of professionals. He noted that specific details of electric fencing technology could also be gained from understanding worldwide electric fencing standards which are reasonably detailed. In considering how long it might take to train an electrical engineer in respect of electric fencing he estimated about two to three months.

372. In summary, it appears likely that a wide range of professionals with electrical engineering, electronics or knowledge of wave technology could up-skill in terms of electric fencing in a relatively short time frame of two to three months. While the combined entity may tie up the most experienced engineers, it is only likely to slow the development of a new electric fencing brand for a short time.

Capital Investment

373. A new entrant in the supply of electric fencing products would need to invest a large amount of capital in producing a complete range of energisers. The capital investment required would be a sunk cost.

374. Sunk costs are generally understood as capital outlay that cannot be recovered (or can only be partially recovered) upon exit. Costs of exit thus will limit the potential entry of third parties in the market, as the risk of non-recovery of the invested capital is high. The Commission considers that the judgement as to whether sunk costs are "high" must be made in relation to the size of the market that a new entrant could serve.

375. From that perspective, the following analysis considers the level of sunk costs and on-going capital commitment required by an existing competitor looking to expand in the electric fencing market.

376. Gallagher submitted that the capital cost of developing a range of energisers amounted to approximately $[ ]. As discussed earlier, the Commission estimates that the total capital cost could amount to $[ ] million.

377. An existing supplier's investment in developing a range of energisers could be recovered through the export markets. Taragate exports some of its products worldwide. However, not only would a new entrant face the a cost of developing these export markets, the largest capital commitment would lie within the development of the high-joule energiser (approximately $[ ]). As discussed earlier, there is little to no demand overseas for these high-joule energisers. As such, an existing supplier is dependent on recovering its costs from a relatively small New Zealand market where only [ ]% of energiser sales are for high-joule energisers.

Intellectual Property

378. In some cases intellectual property rights can amount to a barrier to entry for a new entrant in a market. Intellectual property rights could include patents, trademarks and copyright.

379. Some industry participants advised the Commission that post acquisition, they would be concerned that the combined entity would hold the vast majority of intellectual property rights associated with electric fencing products. For example, [ ], stated:

> Gallagher would almost totally own all the recent Intellectual Property rights pertaining to technological developments and advantages in electric fence energisers and associated accessories.

380. Most electric fencing accessory products, such as tape or plastic insulators, appear to be fairly generic, commodity-type products. Fringe competitors such as Taragate and Robertson Engineering have been able to enter the electric fencing market with such products. Accordingly, the Commission considers that electric fencing accessories are unlikely to raise any intellectual property concerns unless a competitor produces an exact replica.

381. High-joule energisers require considerable technology in terms of electronics, load sensing devices and remote controls and there is some patent protection on some of these features which may represent a significant barrier to expansion. On the other hand, there is likely to be room for an existing competitor to

introduce new technology into energisers without infringing intellectual property rights. For example, [

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382. On the balance of probabilities, the Commission considers that the fact that a number of other competitors have developed electric fencing components in New Zealand and overseas demonstrates that intellectual property rights are unlikely to amount to a significant barrier to entry for an existing competitor in terms of electric fencing accessories or low joule energisers. However, the Commission notes that the patented high technology features of the high-joule energisers may represent a significant barrier to expansion.

383. In summary, the Commission considers that given the required investment in energisers, the sunk costs are moderate in relation to the total size of the market ($[ ] million from a total market size of approximately $[ ] million) a new entrant could hope to obtain, and this is especially apparent in respect of high-joule energisers. A new entrant would need to gain a relatively high market share to enable it to spread its fixed costs. Hence the sunk costs of developing energisers are considered to represent a moderate barrier to expansion. The Commission also notes that the patented high technology features of the high-joule energisers may represent a moderate to high barrier to expansion.

384. On balance, the Commission considers that the combination of sunk costs and intellectual property in respect of high-joule energisers are likely to represent moderate to high barriers to expansion.

Overall Conclusion on Product Range

385. A new entrant or existing competitor is likely to face a number of barriers in sourcing and/or developing a complete range of electric fencing products acceptable to large rural resellers, namely:

- difficulty in sourcing acceptable energisers for the New Zealand market from overseas (high); and
- in house development costs and intellectual property (moderate).

386. The Commission considers that taken together, sourcing or developing a complete range of electric fencing products, especially in respect of energisers, is likely to represent a significant barrier to entry or expansion in obtaining access to resellers.

Bundling

387. In some cases the bundling of products can constitute a barrier to expansion. A bundled product means that an existing fringe competitor may need to expand in the market with a number of related products in order to compete with the incumbent. This could mean the existing supplier would face increased sunk costs of providing a range of products and services. Further, the incumbent is likely to provide across-the-board rebates and discounts for the bundled goods and services, which could have the effect of tying in its customers, and therefore of increasing an existing supplier's expansion.

388. On the other hand, bundling may have associated benefits for consumers and producers. Bundling can allow producers to exploit economies of scope between bundled products, and economies of scale if bundling has an impact on consumer demand. These benefits may be passed on in the form of lower prices to clients or quality improvements. Consumers may also benefit from bundling through a streamlining of purchasing and a resulting reduction in transaction costs associated with business trades.

389. In the proposed acquisition, prime facie, the Commission considers that an existing supplier would need to provide a large rural reseller with a complete range of electric fencing products. However, there is evidence to suggest that an existing supplier may find it advantageous to also provide other agricultural products such as gates and gate hardware, conventional wire or animal weighing systems in order to gain access for its electric fencing products to large rural resellers.

390. In 2000, Hurricane and Gallagher recognised the need to provide a more comprehensive range of agricultural products to its rural resellers and accordingly formed a sales and marketing agreement for Gallagher to supply conventional wire fencing products to specified rural resellers, who also wished to purchase an entire fencing range from Gallagher, and for Hurricane to supply electric fencing products to certain rural resellers who wished to purchase an entire range from them.

391. As discussed earlier, [

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392. [

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393. [

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394. The Commission acknowledges there is some scope for existing competitors to partner with other suppliers as illustrated by [ ]. However, the Commission nevertheless considers that an existing supplier may need to offer resellers bundles of products (such as gates or animal weighing systems, bundled with electric fencing products) in order to compete with the combined entity. This would result in increased expansion costs to existing suppliers. On balance, the Commission considers that bundling is likely to represent a significant barrier to expansion.

Rebates

395. Tru-Test and Gallagher offer rebates to large rural resellers in order to entice them to switch suppliers or to induce loyalty-buying. These rebates can either be volume-based or flat rebates paid annually.

396. Some small players have stated that they cannot compete with the high rebates offered by Gallagher or Tru-Test. However others, for example O'Brien, have stated that if one's product is manufactured competitively and is therefore competitively priced, rebates should not be a deterrent to expansion.

397. Volume-based rebates, however, may raise competition concerns in terms of barriers to entry or expansion. This is because a fidelity discount scheme which offers discounts that are conditional upon the reseller achieving a required volume of sales can result in a form of exclusive dealing.

398. Under a loyalty discount scheme, exclusivity may occur because the reseller is less likely to switch suppliers as it nears the volume of sales or purchases required for a reward or discount. Switching suppliers would result in the loss of the discount across the entire volume of product supplied. As a consequence, volume-based rebate schemes could create substantial switching costs. A competitor, to encourage the reseller to switch suppliers, might have to offer a substantial discount in order to offset the discount that is lost. Depending on the discount structure, it is possible that, as a buyer nears the required volume of sales the potential discount could exceed the price of the extra units that need to be purchased in order to achieve the required volume and receive the discount.

399. [

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400. [

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401. The Commission notes that volume-based rebates can often be used in response to intense competition and, as a discount, per se may not raise competition concerns. However, the Commission considers that post acquisition, with the combined entity having [ ]% market share and Tru-Test being lost as a fierce competitor, volume-based rebates would be likely to represent a barrier to expansion. This is because resellers with the volume-based rebate schemes in place, such as [ ], could incur a substantial loss of discounts in giving an existing supplier or new entrant more shelf space at the expense of the combined entity. Additionally, the stepped nature of the rebate schemes are designed to capture the majority, if not all, of a reseller's business. As a result, large rural resellers would be "tied" to the combined entity which could foreclose the market to existing competitors wishing to expand and therefore is likely to be a very high barrier to entry or expansion.

Conclusion on Access to Resellers

402. The Commission considers that, overall, gaining access to large rural resellers represents a significant barrier to expansion. While there may be increased scope for large rural resellers to support existing supplier's expansion to encourage competitive tension, existing competitors nonetheless will face a number of barriers to expansion in respect of access to resellers, including:

- brand and reputation (moderate);
- infrastructure (moderate to high);
- product range (high), including:

- difficulties in terms of importing;
- the sunk costs arsing from developing manufacturing capabilities in New Zealand;
- [ ]
- intellectual property; and
- the two year plus timeframe in which to develop a competitive range;

- bundling (high); and
- volume-based rebates (high).

Strategic Barriers

403. In assessing the ease of expansion for an existing supplier or new entrant, the Commission considers the combined entity's ability to engage in strategic behaviour that could, potentially, result in barriers to expansion for an existing supplier.

404. An existing supplier in the electric fencing market is likely to consider how the incumbent would react when it expands. For example, the existing supplier might believe that the incumbent would reduce prices substantially if it were to expand and so reduce the prospective revenue available from entering the market. Therefore, the potential for aggressive competition post-entry could deter expansion.

405. In the proposed acquisition, the combined entity, as the incumbent, would be likely to have first mover advantages allowing it to shape the way the market develops by, for example, reducing or completely deterring the potential for existing competitors to expand within the electric fencing market.

406. In assessing such strategic barriers, the Commission takes into account previous behaviour of the parties to the proposed acquisition.

407. The combined entity would be the only player in a position to offer resellers a complete range of electric fencing products. While a new owner of PEL has a range of energisers, it does not have the high joule technology or flagship energisers. As a result, the combined entity would be in a position to threaten to withdraw its product range, or products of importance to resellers (e.g., high-joule energisers), in response to resellers supporting a new entrant.

[

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408. [

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409. On balance, the Commission considers that post acquisition there would be increased scope for the combined entity to engage in such behaviour in order to deter expansion by small existing competitors.

410. As discussed earlier, the Commission considers that volume-based rebates, which are utilised by Gallagher and Tru-Test, would represent a barrier to expansion for small existing suppliers. With a total market share of [ ]%, the Commission considers there would be increased scope for the combined entity to implement or increase existing volume-based rebates to the large rural resellers in order to deter resellers from allocating shelf space to existing suppliers, post-acquisition. This could have the effect of foreclosing the electric fencing market to existing suppliers looking to expand through rural resellers.

411. In the supply of electric fencing products, the combined entity, with [ ]% market share would have the potential to reinforce the bundling of products by leveraging its market power into related markets by tying in sales of other products to the monopoly product. The fact that a customer would have limited alternative suppliers for a complete range of electric fencing products and no alternative suppliers in respect of 36 joule plus joule energisers, suggests that, post-acquisition, the customer could be forced to purchase a whole other product range rather than just electric fencing products.

412. As discussed earlier, [

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413. The Commission considers there could be increased scope for the combined entity to leverage its market power in the electric fencing market into a number of related markets. In particular, the combined entity would have a strong presence in conventional wire products, gates and gate hardware as well as animal weighing systems and could bind large rural resellers to a number of markets.

414. As discussed earlier, on 1 October 2003 Gallagher became Farmlands preferred supplier through The Farmlands Agreement. [

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415. [

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416. [

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417. The Commission considers that there would be scope, post acquisition, for the combined entity to enter into similar arrangements with other large rural resellers by using rebates, refusals to supply or bundling as incentives for

resellers to enter into exclusive relationships. Accordingly, the incumbent's competitors could be denied access to rural resellers. This foreclosure of rural retail space could create a barrier to expansion which may exclude competing suppliers from the market and/or create or enhance the incumbent's market power.

418. In summary, the Commission considers that, post acquisition, the strategic barriers to entry or expansion are likely to be significant given that the combined entity would be in a strong position (with a market share of [ ]%) to engage in strategic incumbent responses. Such potential responses could include: refusing to supply, offering exclusive deals, large volume-based rebates or the potential leveraging of its market power into other markets.

Conclusion on Barriers to Expansion in the Electric Fencing Market

419. The Commission has considered the various factors relevant to the assessment of the expansion and entry barriers in the supply electric fencing. The Commission concludes that the aggregation of all the barriers to expansion in the electric fencing market results in overall high barriers to expansion in this market.

Possible Expansion by Existing Competitors

420. Post acquisition, there would be six remaining competitors who would make up [ ]% of the rural electric fencing product sector of the market of which a new owner of PEL would make up [ ]%. Gallagher submit that:

> Gallagher consider that without the proposed divestment, there would be sufficient constraints from a combination of both existing and potential participants, to ensure no substantial lessening of competition.

421. Existing competitors' plans for expansion are considered below.

<u>Taragate</u>

422. [

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423. [

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424. In respect of Taragate's expansion, Kerry Powell, Taragate, concluded:

[

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425. [

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Artex

426. In 1994, Artex commenced importing and distributing a solar powered energiser, compression spring loaded gate handles and a range of insulators from Zareba in the United States. Artex did not import energisers from Zareba as at that time mains powered energisers had to be registered to meet New Zealand requirements which was too costly for Artex.

427. [

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428. [

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Robertson Engineering / Daken

429. [

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430. [

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431. [

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432. [

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433. [

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O’Brien

434. O’Brien is well known for its electric fencing reel. The Commission understands that it has been the preferred brand of reel for farmers for a number of years. O’Brien previously distributed its reel through Tru-Test. [ ], O’Brien now independently distributes its reel, along with some plastic electric fencing accessories.

435. [ ]

436. [ ] He states:

[ ]

437. [ ]

The Commission has spoken with the large rural resellers in respect of O’Brien’s expansion. [ ]

438. [ ]

439. [ ]

440. [ ]

441. [ ]

442. [ ]:

[

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443. [

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444. [

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445. [

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446. [

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Hurricane

447. Hurricane is the [ ] supplier of conventional wire products in New Zealand and also supplies gates and gate hardware. Hurricane also distributes Gallagher branded electric fencing products to selected retailers through a sales and marketing agreement with Gallagher (The Hurricane Agreement).

448. [

]. Specifically it states:

[

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449. [

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[

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450. [

]. However, for completeness, the Commission considers Hurricane's possible expansion below.

- [

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451. Nick Calavrias, Steel & Tube, summarised as follows:

[

]

452. The Commission notes that Hurricane is a well known agricultural brand. Further, Hurricane has extensive distribution infrastructures with a number of large rural resellers. Accordingly, the Commission considers that Hurricane has advantages that mitigate to a certain extent the high barriers to expansion faced by other small existing electric fencing suppliers.

453. On the other hand, [

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454. Hurricane will also need to gain the support of the large rural resellers should it choose to independently supply electric fencing products. [

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[

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455. [

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[

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456. [

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457. [

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458. [

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Conclusion on Expansion by Small Existing Competitors

459. The Commission considers that small existing competitors are likely to face high barriers to expansion including:

- limited access to large rural resellers;
- brand and reputation;
- infrastructure;
- high capital costs and a two year plus timeframe to develop a range of energisers;
- volume based rebates;
- bundling; and
- vigorous incumbent response.

460. Due to the height of these barriers, it appears that while expansion from small competitors such as [ ] may be likely, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years.

Possible Expansion of PEL

461. As discussed earlier, the Commission considers that cumulatively, the barriers to entry for new entrants and expansion for existing competitors would be high. The Commission considered the extent to which a new owner of PEL, either a new entrant or a current small competitor, with [ ]% market share faces similar barriers to expansion. Specifically, the Commission considered:

- brand and reputation;
- access to resellers;
- product range and research and development;
- bundling and competitive rebates; and
- strategic behaviour or incumbent response.

Brand & Reputation

462. As discussed earlier, the Commission considered that establishing a recognised brand and reputation that could be acceptable to the large rural resellers represented a moderate barrier to expansion for existing competitors.

463. The Applicant considers that a new owner of PEL would not face such a barrier because it considered PEL to be a well-respected and well-known electric fencing brand.

464. PEL was first established in 1969 and has been manufacturing electric fencing and conventional wire products for over 30 years. PEL was a privately owned company until it was acquired in 2001 by Tru-Test. When Tru-Test acquired PEL it had a market share of approximately [ ]%.

465. Tru-Test advised the Commission that it acquired PEL to become a more effective competitor to Gallagher. [

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466. [

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467. [

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468. [

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469. [

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470. [

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471. On the other hand, industry participants advised the Commission that [ ], PEL was nevertheless a well known brand name. Many industry participants advised the Commission that PEL had historically had a good brand presence. This appeared to be largely due to it being present

in the electric fencing industry for over 30 years. A number of resellers also pointed out that PEL has some well known accessory products such as pigtail standards and a particular design of cut-out switch that is favoured by farmers.

472. The Commission considers on balance that while a new owner of PEL will have the benefit of some existing brand equity and that this equity might make it easier for a new owner of PEL to expand its market share than a de novo entrant, brand and reputation still represents a moderate barrier for the new owner of PEL due to the investment that would need to be made to ensure that [ ].

Access to Resellers

473. As discussed earlier in this report, rural resellers appear unlikely to support fringe competitors or new entrants. In order for PEL to be a competitive constraint on the combined entity, it must gain sufficient reseller support. The Commission spoke with the eight largest rural resellers, about their willingness to support a new owner of PEL in respect of:

- initial access for PEL; and
- support for PEL as it improves its range over two years.

Initial Access

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475. Overall, [ ] concluded:

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491. On balance, [

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Future Access

493. The Commission acknowledges that while initial support from large rural resellers is likely to be limited, it may increase as PEL's product range is improved over time. If support from rural resellers improves within two years post acquisition, there could be scope for PEL to be a constraint on the combined entity.

494. The Commission spoke with a number of large rural resellers on this matter. Specifically, the Commission asked rural resellers if their support of PEL would increase if a new owner of PEL demonstrated research and development that improved the PEL range (but not necessarily completed it) in the first two years post acquisition.

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501. In general, [

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502. Notwithstanding the fact that support from most resellers would be limited during the two years immediately following a successful divestment of PEL, the Commission is of the view that some resellers might at least reconsider their support for a new owner of PEL should the new owner:

- [ ]; and
- [

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503. Given this possibility of future support, the Commission then considered how significant a barrier the development of a PEL product range posed.

Full Product Range / Research and Development

504. As discussed earlier, resellers, when making stocking decisions, place great importance on suppliers of electric fencing products being able to offer a full range. Many resellers consulted by the Commission noted that the top end of the PEL energiser range was incomplete relative to competing brands. In particular, both the Stafix and Speedrite brands have top-end offerings of 36 joule (stored) mains energisers, while PEL only offers up to a 32 joule (stored) mains energiser. For example, [ ] stated :

> The key limitation of the PEL range is its lack of large, mains powered energisers (such as the M36 Stafix product), which are the 'flagship' of an electric fencing brand.

505. The Stafix and Speedrite 36 joule energisers (M36 and Panther 36000, respectively), are advertised as being able to power up to 360 kilometres of fence-line. In comparison, PEL's 32 joule top-end energiser (PEL 632) is advertised as only being powerful enough to electrify up to 300 kilometres of fence-line. The Applicant argued that this variation in power output is "immaterially different".[42]

506. The Commission acknowledges that from a performance standpoint this may possibly be true. However, resellers have emphasised to the Commission that these differences in power ratings do influence the perceptions of users and therefore their own ability to market PEL energisers. For instance, [ ] advised:

[

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507. While PEL does not have an equivalent energiser to the Stafix and Speedrite 36 joule (output) mains unit, Table 5 below shows that the breadth of the PEL energiser range is similar to that of competing brands. The PEL offering across the three broad energiser categories (mains units, battery units, and strip-grazers) is also very similar to those of competing brands.

Table 5: Extent of Energiser Range by Brand as at August 2004

[42] Applicant response, dated 10 August 2004, to the Commission's letter of concern relating to the proposed divestment undertaking, dated 5 August 2004

Type	PEL	Stafix	Speedrite	Gallagher
Mains Energisers	9	7	10	10
Battery Energisers (>1 joule, output)	5	5	4	6
Battery Strip-Grazers (< 1 joule, output)	6	4	6	3
Total	**20**	**16**	**20**	**19**

508. The Commission considers the extent of the PEL energiser range is similar to that of competing brands, excepting the notable absence of a top-end 36 joule (output) energiser. This omission appears to be a pivotal barrier to gaining acceptance and support from resellers. The investment in research and development in updating PEL's range to include a comparable 36 joule energiser is discussed below.

Research and Development

509. Generally, resellers consulted by the Commission were also consistent in the view that the technology and features offered by PEL energisers have lagged behind those of competing brands in recent years. For instance, [ ] stated:

> {PEL} … has become a secondary brand in terms of any new technology or any new IP… It has not been invested into that brand. It has been invested into Speedrite and Stafix, and not so much in the PEL brand… {Tru-Test} have run {PEL} down a little bit, really.

510. [ ] advised:

> Tru-Test have put their research and development money… more into the Stafix range {rather than PEL}, so at the top end the Stafix {rather than PEL} products are competing directly with Gallagher products.

511. On Tru-Test's development of the PEL brand in recent years, [ ] said:

> Tru-Test has not been a good custodian of their own products or their own brand equity.

512. Examples of missing features identified by resellers include:

- integrated remote control and fault-identification technology;
- inferior wave form and pulse technology; and
- radio frequency suppression (RFS).

513. Resellers viewed these missing features as a disadvantage, not only from the point-of-view of performance, but also as a significant drawback in terms of the marketability of the PEL product. For example, [ ] stated:

> … {a PEL energiser} probably needs everything {features} that the other {brands} have got. Whether it needs it from an end-user's point of view is probably debateable, but from a marketing and saleability point of view {a PEL energiser} probably needs all those features.

514. Tru-Test advised the Commission that [

] Tru-Test submitted that [

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]. Tru-Test submitted that [

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515. Based on this evidence, the Commission considers that a potential acquirer of PEL would have a weak intellectual property base from which to advance the energiser range.

516. Some resellers were also of the view that currently PEL energisers are difficult to market because of an inconsistent and dated appearance across the whole range. For instance, [ ] stated:

> {PEL} generally have a very, in my opinion, weak offering at the energiser end. It doesn't have a consistency {in appearance} across the range… and you can easily argue that a lot of the PEL product is actually ugly. It sits badly on the shelf… If you put the three or four brands on the shelf that are out there, {PEL} certainly fall{s} into the 'ugly duckling' category. Appearance-wise, {a PEL energiser} just doesn't have the same impact, and technology-wise {a PEL energiser} just doesn't have the same features that are available from the other two major brands.
>
> {Any acquirer of the PEL brand} would need to get their energiser range looking consistent {before [ ] considered supporting the brand}…

517. Similarly, [ ] stated:

> {the PEL brand} is not as complete in the top end {of the range as other brands, and a buyer of PEL} would probably… {have to} start to redevelop the range and brighten it up and modernise it… it looks old … so {an acquirer of PEL} would have to do a lot work on the brand.

518. All resellers acknowledged the likely long-term benefits of creating competitive tension by supporting an alternative supplier of electric fencing products (particularly energisers) to the combined entity, post-acquisition. However, resellers also advised the Commission that support for a potential acquirer of the PEL brand in the long-run would be conditional on, or at least be made more likely if, the acquirer were to invest in research and development to extend and upgrade the technology and appearance of the PEL energiser range to match that of competing brands. For example, [ ] states:

> If {PEL energisers} don't have the R&D, then we're not going to be buying the product.

519. Generally, most resellers considered the required investment would be considerable.

Development Costs

520. On the expected cost of developing the existing PEL energiser range to match that of competing brands, the Applicant submitted:

> … we estimated that a range of four energisers could be developed in a startup situation for a cost of between [ ]. Any incremental improvements to the existing PEL range will likely be a significantly lower cost than this startup estimate.[43]

521. Tru-Test suggested development costs for the entire energiser range would be significantly higher at approximately [ ]. Tru-Test estimated that of this amount, approximately [ ] would need to be spent in developing the range of high-power energisers.[44]

522. [

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523. As discussed earlier, the Commission's viability study indicates that [

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Engineering Expertise

524. As discussed earlier, it appears likely that a wide range of professionals with training in electrical engineering, electronics or knowledge of wave technology could up-skill enough to begin development work on the PEL energiser range within the relatively short time frame of two to three months. While the combined entity may tie up the most experienced engineers in this field, it is only likely to slow the development of the PEL brand for a short time.

Critical Mass

525. All industry participants consulted by the Commission expressed concern over Clause 3.1 of the Divestment Undertaking, which indicates that the use of the PEL brand would only extend to the New Zealand market. Industry participants argued that a potential acquirer of PEL would require a sufficiently large export market, in addition to a domestic one, to justify the required investment in research and development. For example, [ ]:

> Gallagher are saying that whoever buys {PEL} are allowed the New Zealand business, but not the overseas business, and yet they're the first to tell us that 70% of their business comes from exports… So the purchaser {of PEL} is going to have to … set up {a} production facility to supply what is pretty much a tiny market, which is the New Zealand market, dominated by Gallagher, but not allowed to sell it overseas where most of their revenue potential is.

526. The Commission put these concerns to the Applicant who responded by amending the Divestment Undertaking to "include the use of the PEL brand in Australia".

527. Market share data supplied by Tru-Test shows that PEL sales in the Australian market are approximately [

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[43] Applicant response, dated 10 August 2004, to the Commission's letter of concern relating to the proposed divestment undertaking, dated 5 August 2004.
[44] Tru-Test submission on the proposed divestment undertaking dated 6 August 2004, p. 12.

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528. [

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Timeframe

529. Martin Chandler, Head Engineer, Gallagher, estimated a [ ] timeframe to extend the PEL energiser range to a 36 joule (output) and to integrate the remote control system. The Applicant did not consider any further development was required to the PEL energiser range, so felt a longer development timeframe was unnecessary.

530. However, [ ] advised the Commission that PEL's full energiser range would take at least 2¼ year to be developed fully.[45] This is outside the two year timeframe the Commission usually adopts when applying the LET test in considering entry or expansion into a market.

531. Other industry participants concurred with [ ] assessment of the product development timeframe. For instance, [ ] did not consider it possible to develop the PEL range to a competitive level within two years and [ ] estimated that a one to two year timeframe was required to develop the PEL energiser range to an equivalent level to that of competing brands in the market, all things running smoothly.

532. On the balance of probabilities, the Commission concludes that a potential acquirer of PEL is likely to take over two years in order to render PEL's range of energisers equivalent to, or competitive with, that of the combined entity.

533. Accordingly, the Commission considers that a potential acquirer of PEL might not constrain the combined entity in its first two years as a stand-alone business, and may not even be able to do so within the first two years post acquisition. Taking into account all the issues, the Commission considers that the new owner of PEL is unlikely to have a complete range of energisers acceptable to the resellers within a two year timeframe post acquisition.

Conclusion on Full Product Range and R&D

534. The Commission considers that the cost of the research and development required in the PEL brand is likely to be a significant barrier to expansion. Additionally, it appears likely that it will take over two years to develop PEL's range of energisers to a standard comparable to that of the combined entity's.

[45] These development costs include staffing needs [ ]; tooling for new casings on medium and large energizers [ ]; testing equipment [ ] and; parts and materials [ ] over 2¼ years, all running smoothly.

535. Further, this development will be conducted in an environment where a potential acquirer of PEL could have difficulty maintaining PEL's current market share in the face of limited support from the large rural resellers.

536. The Commission also notes that due to the restricted territory under the divestment undertaking (which is limited to the New Zealand and Australian markets), could reduce the scope for recovery via sales in other international markets. This may limit the extent to which an acquirer of PEL would be prepared to invest in research and development.

537. The Commission concludes that the two year plus timeframe to develop a full product range, together with limited access to resellers and limited available export markets, are likely to be significant barriers to expansion faced by a potential acquirer of PEL.

Rebates

538. As discussed earlier, the Commission considers that post acquisition, with the combined entity having significant market share and Tru-Test being lost as an effective competitor, volume-based rebates could represent a barrier to expansion. This is because resellers with the volume-based rebate schemes in place, such as [ ], could incur a substantial loss of discounts in giving an existing supplier, such as PEL, more shelf space at the expense of the combined entity. As a result, large rural resellers could be "tied" to the combined entity, which could foreclose the market to existing competitors wishing to expand.

539. The Commission considers that a new owner of PEL is also likely to face this same barrier in respect of its expansion. As a result, the Commission considers that volume-based rebates are likely to represent a very high barrier to expansion.

Strategic Barriers to Expansion

540. As discussed earlier in this Decision, the Commission considers that, post acquisition, the strategic barriers to entry in the electric fencing market would be likely to increase as previous behaviour by both Gallagher and Tru-Test indicate that the combined entity with [ ]% of the relevant market, is likely to react strongly to any new entry by, for example, refusing to supply, offering exclusive deals, large volume-based rebates or leveraging its market power into other markets.

541. Gallagher states that as it considers PEL will be an effective constraint on the merged entity, it will be precluded from engaging in such strategic behaviour.

542. However, the Commission notes that the combined entity's market share will still be very high [ ]. Further, as PEL does not have the requisite technology in terms of high-joule technology, there is also increased scope for the combined entity to engage in strategic behaviour that could limit PEL's expansion.

543. For example, [

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544. The Commission also notes that any support of PEL will necessarily mean less shelf space for the combined entity. The rural reseller could therefore forgo a portion of their volume-based rebates from the combined entity in order to accommodate PEL.

545. Overall, the Commission considers that PEL would face the threat of incumbent response post acquisition and that strategic response is likely to remain a high barrier to a new owner of PEL.

Conclusion on Expansion of PEL

546. The Commission considers that PEL, either on its own or with a small competitor, would be likely to face high barriers to expansion in the electric fencing market. Notably, PEL faces:

- limited short to medium access to the large rural resellers;
- restoring brand and reputation;
- high capital costs and a two year plus timeframe to develop and upgrade PEL's range of energisers;
- [ ];
- volume-based rebates;
- bundling; and
- vigorous incumbent response.

547. The Commission considers that a potential acquirer of PEL, provided it had sufficient funds, could improve its access to resellers by upgrading its product range by investing in research and development. However, the research and development needed to offer a sufficiently competitive alternative to that of the combined entity would be likely to take over two years to complete; would be conducted in the face of limited access to resellers; would likely encounter vigorous incumbent response; and would require significant funding.

548. Accordingly, it appears that due to the cumulatively high expansion barriers faced by PEL, as well as the two year plus time-frame required to develop a complete product range, expansion by PEL is likely to be limited at best. In the event that expansion did occur, the Commission concludes it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years, and would not result in the restoration of the competitive levels evident in the counterfactual.

549. Having considered the impact of the key barriers noted earlier of a possible purchase of PEL by one or either of the current small competitors, the Commission is of the view that such a purchase would not alter this conclusion.

New Entry

550. The Commission considers that the high barriers to expansion discussed above are also likely to be faced by a new entrant.

The LET Test

551. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be *Likely,* sufficient in *Extent* and *Timely* (the LET test).

Likelihood of Entry

552. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power, and would not alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational business would be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

553. The Commission could not identify any potential domestic entrants in respect of electric fencing. However, the Commission considers that potential entry could occur via an existing overseas suppliers of either rural or security electric fencing products.

554. The Commission has contacted Thunderbird in Australia. Thunderbird is an Australian supplier of rural electric fencing products and estimates that it has approximately [ ]% market share in Australian electric fencing products. Thunderbird advised the Commission that [

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557. The Commission contacted other overseas manufacturers of rural electric fencing products. Companies from the United States and Europe, in particular [ ] stated that they are unlikely to enter the market with rural electric fencing products for the following reasons:

- the capital investment required to develop high-joule energisers, for which there is little to no demand in their home markets;
- freight costs associated with supplying the New Zealand market; and
- inherent risks and strategic barriers that they would face in entering a market where the incumbent has a [ ]%+ market share, and where it is difficult to persuade rural resellers to stock an overseas brand that is unproven in New Zealand.

558. As discussed in the Existing Competition section of this Decision, post acquisition, there would be no supplier of security electric fencing products in

New Zealand other than the combined entity, who could impose a potential supply-side constraint on the rural electric fencing segment of the market.

559. In considering the likelihood of overseas entry via suppliers of security electric fencing products, the Commission considers that these suppliers would face the same risks and high entry barriers as overseas suppliers of rural electric fencing products. Overseas suppliers of security electric fencing products would inevitably face issues in respect of brand and reputation, infrastructure, and incumbent response.

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Overseas suppliers advised the Commission that they also considered the small size of the New Zealand market and the accompanying freight costs a barrier to entering the New Zealand market. The Commission notes that total size of the security electric fencing is only NZ$[ ] which accounts for just [ ]% of the total electric fencing market in New Zealand. In respect of security electric fencing, [

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560. Overall, the Commission considers that due to the small size of the security electric fencing segment and other barriers such as brand and reputation, infrastructure and technical support, and incumbent response, it appears unlikely that an overseas supplier of security or rural electric fencing would enter the New Zealand market and supply just security fencing as a means of gaining a toehold in either security or rural electric fencing. Even if an overseas supplier of security electric fencing products entered New Zealand, it would still face the same high barriers in attempting to penetrate the rural segment of the market. The Commission therefore concludes that overseas suppliers of security electric fencing are unlikely to constrain the combined entity in either the security or rural segments of the market.

Conclusion on New Entry

561. Overall, the Commission considers that [ ] would be unlikely entrants and are therefore unlikely, via either security or rural electric fencing products, to prevent the combined entity from raising its prices or reducing the quality of product and service it currently provides.

Countervailing Power of Buyers or Suppliers

562. The potential for a business to wield market power may be constrained by countervailing power in the hands of its customers, or when considering buyer market power (oligopsony or monopsony), its suppliers. In some circumstances,

this constraint may be sufficient to eliminate concerns that an acquisition would be likely to lead to a substantial lessening of competition.

563. In terms of rural electric fencing products, the eight large rural resellers account for approximately 85% of all electric fencing products sold in New Zealand. The Applicant submitted that "the top eight rural resellers represent approximately 85% of the material reseller stores and the gain or loss of any of these key customers by a participant creates a competitive environment which constrains the combined entity".

564. [

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565. The Commission considers that the large rural resellers currently have strong countervailing power, which is especially highlighted by the healthy competitive tension between Gallagher and Tru-Test as discussed previously in this Decision.

566. Resellers advised the Commission that post acquisition, their bargaining power would be reduced significantly.

567. For example, [ ], advised the Commission that:

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568. Most rural resellers stated that with Tru-Test lost as an equivalent competitive alternative, and PEL as a likely weak brand providing little or no competitive constraint in the initial two years, they would have no choice but to stock the combined entity's products. Some resellers also advised that they had limited experience or desire to source electric fencing products overseas due to the fact that they perceived overseas products to be inferior and not able to meet the demands of New Zealand farmers. They advised the Commission that any price increases would be passed onto their customers.

569. The Commission considers that any countervailing power presently held by the large rural resellers is likely to be significantly reduced post-acquisition because:

- the competitive tension between Gallagher and Tru-Test which enabled large rural resellers to exert countervailing power would be lost;
- PEL is unlikely to be a competitive constraint within the two years immediately following the acquisition;
- resellers have limited options to seek alternative supply from abroad, given a perception of overseas electric fencing products being inferior in quality and unsuitable for New Zealand farming conditions; and
- the fact that the likelihood or extent of expansion by any other existing or potential entrant is limited.

570. Security fencing contractors would similarly lose the choice of having two evenly matched suppliers. For the same reasons discussed above with regard to

rural electric fencing products, any countervailing power presently held by electric security fencing customers is likely to be significantly reduced post-acquisition

Conclusion on Countervailing Power in Electric Fencing

571. The Commission considers that the countervailing power of large rural resellers would be substantially reduced as a result of the proposed acquisition and would be insufficient to prevent the combined entity from raising prices or reducing the quality of product and service.

Overall Conclusion on the Electric Fencing Market

572. In the case of the electric fencing market, the loss of existing competition between Gallagher and Tru-Test as a result of the proposed acquisition is considered to be very significant, particularly as there is currently a strong competitive tension between Gallagher and Tru-Test. This very significant loss of existing competition evident in the counterfactual is unlikely to be restored by fringe competitors in the factual within two years of the acquisition.

573. In the case of the electric security segment of the market, there would be a 100% aggregation in market share and it is likely that there would be a substantial lessening of competition in this segment under the factual. Further, this segment is unlikely to provide any significant competitive constraints on the rural segment within two years of the acquisition.

574. While the Commission notes that the divestment of PEL reduces the combined entity's market share in respect of rural electric fencing products from [ ]% to [ ]%, the proposed acquisition nevertheless still results in a very significant loss of existing competition. PEL's segment share is [

] further undermines its ability to act as an effective constraint on the combined entity post acquisition. In the counterfactual, Gallagher and Tru-Test would remain two equally matched competitors that would continue to fiercely compete in terms of price and innovation. The divestment of PEL would be unlikely to restore such fierce existing competition in the factual within two years.

575. The Commission has found a number of high barriers to entry and/or expansion within a two year timeframe, namely:

- access to resellers;
- brand and reputation;
- infrastructure;
- the sunk costs (arising from developing manufacturing capabilities in New Zealand), the potential lack of critical mass, intellectual property, and the need to develop a complete product range;
- bundling;
- volume-based rebates; and
- strategic barriers or incumbent response.

576. Due to the height of these barriers, it appears that while expansion from small competitors such as [ ] may be likely,

it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years.

577. The Commission considers that overseas suppliers such as [ ] would be unlikely entrants and are therefore unlikely, via either security or rural electric fencing products, to prevent the combined entity from raising its prices or reducing the quality of product and service it currently provides.

578. The Commission considers that PEL would be likely to face high barriers to expansion in the electric fencing market. Notably, PEL faces:

- limited short to medium term access to the large rural resellers;
- restoring brand and reputation;
- hight capital costs and a two year plus timeframe to develop and upgrade PEL's range of energisers;
- [ ];
- volume-based rebates;
- bundling; and
- vigorous incumbent response.

579. The Commission considers that a potential acquirer of PEL, provided it had sufficient funds, could improve its access to resellers by upgrading its product range by investing in research and development. However, the research and development needed to offer a sufficiently competitive alternative to that of the combined entity would be likely to take over two years to complete; would be conducted in the face of limited access to resellers; incumbent response; and would require significant funding.

580. Accordingly, it appears expansion by PEL is likely to be limited at best. In the event that expansion did occur, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years, and would not result in the restoration of the competitive levels evident in the counterfactual.

581. Given the limited extent of any likely entry or expansion, the large rural resellers and security electric fencing customers would have limited ability to exercise countervailing power under the factual (in comparison with the counterfactual) to prevent the combined entity from raising prices or reducing the quality of product and service supplied.

582. Overall, the Commission considers that the difference between the factual and the counterfactual is that two equally matched competitors driving fierce competition would no longer exist in the factual and fringe players in the counterfactual would remain fringe players in the factual and would be insufficient to constrain the combined entity. Similarly, the divestment of PEL is considered unlikely to restore fierce existing competition in the factual.

583. Table 1 illustrates this comparison of the counterfactual with the factual.

Table 1: Comparison between Counterfactual and Factual

	Counterfactual	Factual
Existing Competition	Fierce competition between two evenly matched firms, Gallagher and Tru-Test.	Fierce existing competition between Gallagher and Tru-Test is lost and is unlikely to be restored by fringe competitors or PEL.
Barriers to Entry and Expansion	High	Remain high
Existing Competitor's Expansion	Limited - would take over two years and would face high barriers to becoming a competitive alternative.	Possible expansion by fringe competitors or PEL would face high barriers and would be unlikely to restore fierce competition evident in the counterfactual.
Potential Overseas Competition	None – due to small size of NZ market, freight costs and the cost of developing high joule energisers.	None – due to reasons in counterfactual and the added risk of incumbent response.
Countervailing Power	High as large resellers have strong competitive alternatives.	Significantly weakened with loss of competition between two fierce competitors.

584. Taking into account all the relevant issues, the Commission concludes that the acquisition would be likely to lead to a substantial lessening of competition in the manufacture and supply of electric fencing products.

The Conventional Wire Fencing Market

585. The Applicant distributes Hurricane branded conventional wire products via a sales and marketing agreement with Hurricane to selected rural resellers. The Applicant's annual revenue from the distribution of conventional wire products was [ ] for the twelve months ended December 2003.

586. The Commission notes that post acquisition, the combined entity would continue to be Hurricane's sales and market agent for conventional wire products to a small number of rural resellers. [

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587. [ ]

588. Tru-Test manufactures and supplies conventional wire products through its fully owned subsidiary Cyclone. Cyclone's annual revenue from the supply of conventional wire products is approximately [ ]. Hurricane, Cyclone's next largest competitor, has an annual revenue of approximately [ ]. There are a number of other smaller competitors who also supply conventional wire products.[46]

589. The total market for the distribution of conventional wire products is estimated to be [ ].[47] If the combined entity continued to supply conventional wire

[46] For example, Eurocorp who has an annual revenue of approximately $[ ].
[47] The total market size is based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

products through a sales and marketing agreement with Hurricane, post acquisition, the combined entity would likely increase its market share by [ ]%. [

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590. The Commission considers that the Gallagher / Hurricane Arrangement represents [ ] and of the market itself and is therefore is unlikely to raise any competition concerns. The Commission concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the conventional wire market due to only minor aggregation and the presence of a number of large existing competitors.

The Fence Posts Market

591. Gallagher's annual revenue from the distribution of fence posts is [ ].[48] Tru-Test also supply steel posts and its annual revenue from these products is [ ]. The total market for the distribution of fence posts used for rural fencing is estimated to be [ ].[49] Post acquisition, the combined entity would account for [ ]% of the market. The three largest distributors, Goldpine, Ramsey and CHH account for approximately [ ] of the market. There are also a large number of local round-wood post suppliers who supply regional markets.

592. Given the small market share that would be held by the combined entity and the presence of Goldpine, Ramsey Roundwood Limited, Carter Holt Harvey Limited and a number of small local suppliers who supply timber round-wood posts, the Commission does not consider the level of aggregation merits further examination in the competition analysis.

593. The Commission concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the fence posts market due to only minor aggregation and the presence of a number of large existing competitors.

The North Island Gates Market

594. The Commission considers the appropriate measure to determine market share in this market is the revenue earned from the sales made of the products represented in the North Island gates market. Table 7 below sets out the estimated market shares of the combined entity and other competitors in the North Island gates market based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

[48] Gallagher supply "Insultimber", fibreglass and steel "Kiwitah" posts.

[49] This excludes permanent posts used in horticulture or viticulture. The total market size is based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

Table 7: Market Shares for the North Island Gates Market

Company	2003 ($)	Market share (%)
Gallagher	[ ]	[ ]
Tru-Test	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**
Greyson	[ ]	[ ]
Hurricane	[ ]	[ ]
Walker Ltd	[ ]	[ ]
Others[50]	[ ]	[ ]
Total	[ ]	**100**

595. Post acquisition, the combined entity would have a market share of [ ]%. The current three firm concentration ratio is [ ]%. Post acquisition the three firm concentration ratio would be [ ]%. The market shares in the market would be outside the Commission's safe harbours guidelines.

596. Post acquisition, the combined entity would be the largest provider of gates and gate hardware in the North Island. However, the combined entity would continue to face competition from existing competitors such as Greyson, Hurricane and Walker Ltd.

Hurricane

597. The Applicant contract manufactures gates and gate hardware for Hurricane under the sales and marketing agreement between Gallagher and Hurricane that was first established in 1998 (the Hurricane Gates Agreement). Hurricane purchased $[ ] of gates and gate hardware from the Applicant in 2003. Hurricane has its own manufacturing plant for gates and gate hardware in the South Island and therefore does not purchase any gates or gate hardware for the South Island from Gallagher.

598. [

]

[50] The Commission notes that it received higher estimates of "others" from industry participants, but has taken a conservative estimate in order to highlight the market shares of the main competitors to the combined entity.

599. On balance, the Commission considers that despite the Hurricane Gates Agreement, Hurricane will represent a strong constraint on the combined entity post acquisition.

Greyson

600. Greyson and Tru-Test have recently entered into a sales and marketing arrangement whereby Tru-Test is Greyson's exclusive distributor of gate hardware. [

]

601. [

]

602. On balance, the Commission considers that Greyson, [ ], is likely to remain a constraint on the combined entity due to its established brand and links with the rural resellers.

Walker Ltd

603. Walker Ltd's core business is the supply of gate hardware and it predominately sells gate hardware to building supply stores and independent rural resellers such as the Ashburton Trading Society. Brian Walker, Walker Ltd, advised the Commission that it would be the [ ] gate hardware supplier behind Gallagher.

604. [

]

605. [

] The Commission notes that, unlike electric fencing products, gates are largely an undifferentiated commodity product where there appears to be few issues involved for a large rural reseller in building a second brand.

606. The Commission considers that post acquisition, Walker Ltd is likely to constrain the combined entity as Walker Ltd appears to be a recognised brand (through its previous relationship with Tru-Test). Further, it is in a position to offer rural resellers a full range of gate hardware as an alternative to the combined entity.

Others

607. The Commission notes the presence of a number of small local engineering firms who are able to produce and supply wooden or steel gates and gate hardware to farmers. The Commission understands that farmers themselves also make their own gates. The Commission estimates that together, local engineering firms and the farmers themselves would make up approximately [ ]% of the market. Accordingly, there is some scope for farmers to source gates from a local firm or simply construct the gate themselves in the face of the combined entity either raising its price or reducing the quality of its service.

Conclusion on Existing Competition in the North Island Gates Market

608. The Commission considers that existing competition would be likely to constrain the combined entity post acquisition due to:

- the presence of Hurricane, Greyson and Walker Ltd; and
- the presence of a number of small local engineering firms, and the farmers themselves, who could bypass the rural resellers and construct wooden or steel gates themselves.

609. The Commission concludes that the proposed acquisition is therefore unlikely to result in a substantial lessening of competition in the North Island gates market due to the presence of existing competition.

The South Island Gates Market

610. The Commission considers the appropriate measure to determine market share in this market is the revenue earned from the sales made of the products represented in the South Island gates market. Table 8 below sets out the estimated market shares of the combined entity and other competitors in the South Island gates market based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

Table 8: Market Shares for the South Island Gates Market

Company	2003 ($)	Market share (%)
Gallagher	[ ]	[ ]
Tru-Test	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**
Hurricane	[ ]	[ ]
Greyson	[ ]	[ ]
Walker Ltd	[ ]	[ ]
Others[51]	[ ]	[ ]
Total	**[ ]**	**100**

611. Post acquisition, the combined entity would have a combined market share of [ ]%. The current three firm concentration ratio is [ ]%. Post acquisition the three firm concentration ratio would be [ ]%. The market shares in the market would be outside the Commission's safe harbours guidelines.

612. Post acquisition, the combined entity would be the [ ] provider of gates and gate hardware in the South Island. However, as discussed in the North island gates market, the combined entity would continue to face competition from existing competitors such as Greyson, Hurricane, Walker Ltd, local engineering firms and farmers themselves.

Conclusion on Existing Competition in the South Island Gates Market

613. The Commission considers that existing competition would be likely to constrain the combined entity post acquisition due to:

- The presence of Hurricane, Greyson and Walker Ltd; and
- The presence of a number of small local engineering firms and the farmers themselves who could bypass the rural resellers and construct wooden or steel gates themselves.

614. The Commission concludes that the proposed acquisition is therefore unlikely to result in a substantial lessening of competition in the South Island gates market due to the presence of existing competition.

The Animal Weighing Systems Market

615. The Commission considers the appropriate measure to determine market share in this market is the revenue earned from the sales made of the products represented in the animal weighing systems market. Table 9 below sets out the estimated market shares of the combined entity and other competitors in the animal weighing systems market based on figures provided by the Applicant and information obtained in the course of the Commission's investigation.

[51] The Commission notes that we received higher estimates of "others" from industry participants, but we have taken a conservative estimate in order to highlight the market shares of the main competitors to the combined entity.

Table 9: Market Shares for the Animal Weighing Systems Market 2003

Company	2003 ($)	Market share (%)
Tru-Test	[ ]	[ ]
Gallagher	[ ]	[ ]
COMBINED ENTITY	**[ ]**	**[ ]**
Iconix	[ ]	[ ]
Sensortronic	[ ]	[ ]
Atrax	[ ]	[ ]
TOTAL	[ ]	100

616. Post acquisition, the combined entity would have a combined market share of [ ]%. The current three firm concentration ratio is [ ]%. Post acquisition the three firm concentration ratio would be [ ]%. The market shares in the animal weighing systems market would be outside the Commission's safe harbours guidelines.

617. Post acquisition, the combined entity would be the largest provider of animal weighing systems. However, the combined entity will continue to face competition from Iconix which has a market share of [ ]%. [

]

618. [

]

619. [

]

- [

]

620. [

]

Conclusion on Existing Competition in the Animal Weighing Systems Market

621. In the market for supply of animal weighing systems, the Commission considers that existing competition would be likely to constrain the combined entity post acquisition due to:

- the presence of Iconix who has [ ] market share; and
- [

]

622. The Commission therefore concludes that the proposed acquisition is unlikely to result in a substantial lessening of competition in the animal weighing systems market due to the presence of existing competition.

OVERALL CONCLUSION

623. The Commission has considered the probable nature and extent of competition that would exist in the following markets:

- the electric fencing market;
- the conventional wire fencing market;
- the fence posts market;
- the North Island gates market;
- the South Island gates market; and
- the animal weighing systems market.

624. The Commission considers that the appropriate counterfactual is the status quo.

625. The Commission is satisfied that the proposed acquisition would not have nor would be likely to have the effect of a substantial lessening of competition in the fence posts market, the conventional wire fencing market, the North Island Gates market, the South Island gates market, and the animal weighing systems market due to the constraint on the combined entity that would be provided by existing competition.

The Electric Fencing Market

626. In the case of the electric fencing market, the loss of existing competition between Gallagher and Tru-Test as a result of the proposed acquisition is considered to be very significant, particularly as there is currently a strong competitive tension between Gallagher and Tru-Test. This very significant loss of existing competition evident in the counterfactual is unlikely to be restored by fringe competitors in the factual within two years of the acquisition.

627. In the case of the electric security segment of the market, there would be a 100% aggregation in market share and it is likely that there would be a substantial lessening of competition in this segment under the factual. Further, this segment is unlikely to provide any significant competitive constraints on the rural segment within two years of the acquisition.

628. While the Commission notes that the divestment of PEL reduces the combined entity's market share in respect of rural electric fencing products from [ ]% to [ ]%, the proposed acquisition nevertheless still results in a very significant loss of existing competition. PEL's segment share is [

] further undermines its ability to act as an effective constraint on the combined entity post acquisition. In the counterfactual, Gallagher and Tru-Test would remain two equally matched competitors that would continue to fiercely compete in terms of price and innovation. The divestment of PEL would be unlikely to restore such fierce existing competition in the factual within two years.

629. The Commission has found a number of high barriers to entry and/or expansion within a two year timeframe, namely:

- access to resellers;
- brand and reputation;
- infrastructure;
- the sunk costs (arising from developing manufacturing capabilities in New Zealand), the potential lack of critical mass, intellectual property, and the need to develop a complete product range;
- bundling;
- volume-based rebates; and
- strategic barriers or incumbent response.

630. Due to the height of these barriers, it appears that while expansion from small competitors such as [ ] may be likely, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years.

631. The Commission considers that overseas suppliers such as [ ] would be unlikely entrants and are therefore unlikely, via either security or rural electric fencing products, to prevent the combined entity from raising its prices or reducing the quality of product and service it currently provides.

632. The Commission considers that PEL would be likely to face high barriers to expansion in the electric fencing market. Notably, PEL faces:

- limited short to medium term access to the large rural resellers;
- restoring brand and reputation;
- hight capital costs and a two year plus timeframe to develop and upgrade PEL's range of energisers;
- [ ];
- volume-based rebates;
- bundling; and
- vigorous incumbent response.

633. The Commission considers that a potential acquirer of PEL, provided it had sufficient funds, could improve its access to resellers by upgrading its product range by investing in research and development. However, the research and development needed to offer a sufficiently competitive alternative to that of the combined entity would be likely to take over two years to complete; would be conducted in the face of limited access to resellers; incumbent response; and would require significant funding.

634. Accordingly, it appears expansion by PEL is likely to be limited at best. In the event that expansion did occur, it would be insufficient in extent to prevent the combined entity from raising prices or reducing the quality of product or service at least over the next two years, and would not result in the restoration of the competitive levels evident in the counterfactual.

635. Given the limited extent of any likely entry or expansion, the large rural resellers and security electric fencing customers would have limited ability to exercise countervailing power under the factual (in comparison with the counterfactual) to prevent the combined entity from raising prices or reducing the quality of product and service supplied.

636. Overall, the Commission considers that the difference between the factual and the counterfactual is that two equally matched competitors driving fierce competition would no longer exist in the factual and fringe players in the counterfactual would remain fringe players in the factual and would be insufficient to constrain the combined entity. Similarly, the divestment of PEL is considered unlikely to restore fierce existing competition in the factual.

637. Table 1 illustrates this comparison of the counterfactual with the factual.

Table 1: Comparison between Counterfactual and Factual

	Counterfactual	Factual
Existing Competition	Fierce competition between two evenly matched firms, Gallagher and Tru-Test.	Fierce existing competition between Gallagher and Tru-Test is lost and is unlikely to be restored by fringe competitors or PEL.
Barriers to Entry and Expansion	High	Remain high
Existing Competitor's Expansion	Limited - would take over two years and would face high barriers to becoming a competitive alternative.	Possible expansion by fringe competitors or PEL would face high barriers and would be unlikely to restore fierce competition evident in the counterfactual.
Potential Overseas Competition	None – due to small size of NZ market, freight costs and the cost of developing high joule energisers.	None – due to reasons in counterfactual and the added risk of incumbent response.
Countervailing Power	High as large resellers have strong competitive alternatives.	Significantly weakened with loss of competition between two fierce competitors.

638. Taking into account all the relevant issues, the Commission concludes that the acquisition would be likely to lead to a substantial lessening of competition in the manufacture and supply of electric fencing products.

DETERMINATION ON NOTICE OF CLEARANCE

639. Pursuant to section 66(3)(b) of the Commerce Act 1986, the Commission determines to decline to give clearance for the proposed acquisition by Gallagher Group Holdings Limited of all the ordinary shares of Tru-Test Corporation Limited.

Dated this 26th day of August 2004

Paula Rebstock
Chair
Commerce Commission

Appendix 1

Insert Appendix 1 from the amended application

[ ]