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COMMERCE COMMISSION

Decision No. 431

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

Nelson Pine Industries Limited

and

Rayonier MDF New Zealand

The Commission:	M J Belgrave (Chair) Dr M N Berry P J M Taylor
Summary of Proposed Acquisition:	Nelson Pine Industries Limited or any of its interconnected bodies corporate to acquire up to 100% of the shares in Rayonier MDF New Zealand or all of the medium density fibreboard processing assets and business of Rayonier and/or any of its interconnected bodies corporate at Mataura.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	31 May 2001

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS [ ]

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THE PROPOSAL

1 On 4 May 2001, the Commission registered a notice ("the Application") pursuant to section 66(1) of the Commerce Act 1986 (the Act), seeking clearance by Nelson Pine Industries Limited or any of its interconnected bodies corporate to acquire up to 100% of the shares in Rayonier MDF New Zealand or all of the medium density fibreboard processing assets and business of Rayonier and/or any of its interconnected bodies corporate at Mataura.

THE PROCEDURES

2 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. The Applicant agreed to an extension of nine working days. Accordingly, a decision on the Application is required by 31 May 2001.

3 The Applicants sought confidentiality for certain information contained in the Application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the Application. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.

4 The Commission's determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.

5 In the course of their investigation of the proposed acquisition, Commission staff have discussed the Application with a number of parties. These parties included other manufacturers of MDF and related products, distributors, builders, joiners, kitchen manufacturers, the Building Research Association of New Zealand (BRANZ), wood dealers and forest owners.

THE PARTIES

Nelson Pine Industries Limited ("NPIL")

6 NPIL is a wholly owned subsidiary of Sumitomo Forestry NZ Limited, a New Zealand resident company, which in turn is wholly by Sumitomo Forestry Co. Ltd, a Japanese based wood processing company.

7 The major business activity of NPIL is the manufacture and sale of medium density fibreboard ("MDF"). NPIL manufactures MDF at its processing facility in Richmond, Nelson. The MDF manufactured by NPIL is sold under the brand name "GoldenEdge MDF".

8 NPIL uses exotic radiata pine, sourced from the Nelson region. NPIL owns a 4,500 ha forest estate in the Nelson region, which produces 40,000m^3 of wood per annum.

9 Over 80% of the MDF produced by NPIL is exported, principally to Asia and the Pacific Rim. The remaining MDF is sold on the domestic market either to distributors or directly to end-users.

Rayonier MDF New Zealand (“Rayonier”)

10 Rayonier is a wholly owned subsidiary of Rayonier Inc, a global forestry and wood products company based in the United States. It produces speciality pulp, timber and wood products in a number of countries and markets and distributes these products worldwide.

11 Rayonier has a manufacturing plant at Mataura, and exports most of the MDF it produces. It also sells to the domestic market, under a contract with Fletcher Wood Panels Limited (“FWP”), which is ultimately owned by Fletcher Building Limited. The MDF manufactured by Rayonier is sold under the brand name “Patinna” in international markets but under FWP’s brand name, “Lakepine,” when sold in New Zealand.

12 Rayonier Inc is the largest forestry owner in Southland, with 33,000 ha of forest estate in the region.

Carter Holt Harvey Limited (“CHH”)

13 CHH, which is listed on the New Zealand and Australian Stock Exchanges, has substantial interests in forests, wood products, pulp and paper, tissue, packaging and building products. CHH owns Canterbury Timber Products Limited (“CTP”). CTP operates an MDF plant at Rangiora, north of Christchurch

Fletcher Building Limited (“FBL”)

14 FBL owns FWP, which operates an MDF plant at Taupo. FBL is a publicly listed company, which commenced trading on the New Zealand, Australian and New York stock exchanges on 23 March 2001. FBL is a building materials manufacturer and distributor with operations in concrete, steel, plasterboard, panel products, and residential and commercial construction. It operates in New Zealand, South Pacific, South America, Australia and India.

Other Relevant Parties

15 Major purchasers of MDF in New Zealand are distributors, including Carters (owned by CHH), Scott Panel and Hardware (owned by FBL), Placemakers (50% owned by FBL), and other independent distributors such as Mitre 10, Independent Timber Merchants (ITM), and Benchmark Building Supplies.

16 In addition there are a number of other parties who directly purchase MDF from the producers. These include builders, joiners and kitchen manufacturers.

17 Various wood suppliers to NPIL and Rayonier’s Mataura plant were also interviewed.

BACKGROUND

MDF

18 MDF is a reconstituted wood-based panel product used in many interior construction applications, predominantly kitchens, furniture and cabinetry. The basic input required in the production of MDF is wood fibre, in the form of wood chips. The process may be summarised as follows: the woodchips are broken down into wood fibres, resin is added, the resulting material is then dried, formed and pressed. Pressing may be either into a continuous sheet or into separate sheets, depending on the technology of the particular plant or production line used. The MDF board is then sanded and cut as required.

19 MDF plants produce a range of MDF boards of different densities and thicknesses. Most MDF plants can produce boards from three to 35 millimetres thick. The standard thickness is 16 or 18 millimetres, and boards less than nine millimetres thick are classified as thin board. Plants can also produce boards of different densities, and lower density boards are referred to as “light” MDF. Standard MDF has a density of about 720 kilograms per cubic metre, while light has a density of about 600 kilograms per cubic metre. Of the four manufacturers of MDF in New Zealand, all can produce the full range of MDF with the exception of FWP.

MARKET DEFINITION

Introduction

20 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

21 Section 3(1A) of the Act provides that:

> “. . . the term ‘market’ is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them.”

22 Relevant principles relating to market definition are set out in Telecom Corporation of New *Zealand Ltd v Commerce Commission*,[1] and in the Commission’s *Business Acquisition Guidelines* (“the Guidelines”).[2] A brief outline of the principles follows.

23 Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

24 A properly defined market includes products which are regarded by buyers or sellers as being not too different (‘product’ dimension), and not too far away (‘geographical’ dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a “small yet significant and non-transitory increase in price” (the *“ssnip”* test), assuming that other terms of sale remain unchanged.

25 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be

[1] (1991) 4 TCLR 473.
[2] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the Application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the “manufacturing market”, while that between wholesalers and retailers is usually known as the “wholesaling market”.

The Relevant Markets

26 The Applicant in this case has contended that the relevant markets are:

- the New Zealand wide market for the manufacture and supply of MDF to distributors and end-users; and
- the relevant regional markets for the supply/acquisition of wood fibre.

Product Markets

MDF

27 For the purposes of this Application, the Applicant has submitted that a narrow market, that for MDF only, is appropriate. However it has also acknowledged that the market could be seen more broadly as the construction materials market, and it stated (Paragraph 16.3 of the Application) that particle board can be substituted in all applications of MDF. The Applicant referred to Decision No 213, where the Commission defined markets for the wood-based panel industry by reference to the end-use of the relevant wood products. In that case, decided in 1987, a key end-use market for wood-based panel products was seen as that for the residential flooring construction market.

28 As mentioned earlier, MDF is manufactured in a variety of thicknesses and densities. The standard thickness MDF is 16-18 millimetres thick, while thin board is defined as nine millimetres or less.

29 FWP raised an issue as to whether thin MDF was such a specialised product that it should be considered to be a separate market from other MDF. Thin MDF is used when a thin but strong board is required such as for backing on furniture, drawer bottoms, doorskins, and flooring overlay. FWP indicated that, in its view, there were no acceptable substitutes for some of these applications. For example, it said particle board is not made in thicknesses less than nine millimetres and therefore cannot be used as a substitute. Thin plywood and hardboard were considered too expensive to be realistic substitutes.

30 The Commission considers it unlikely that there is a separate market for thin MDF. It noted FCL’s previous submission in Decision No 213, mentioned above, that markets for the wood-based panel industry should be defined with reference to the end use of the relevant wood products, an approach that was subsequently adopted by the Commission.

31 The Commission also noted, with respect to the supply side, that with the exception of the FWP plant at Taupo, the other three MDF manufacturers’ plants are able to produce both thin and thick MDF on their production lines. In view of this factor, and the constraints outlined in paragraph 76 of this report, the Commission does not consider that it is necessary to determine whether thin MDF is a separate product to standard MDF. For the purposes of this application, the Commission proposes to consider that thin MDF falls within the same product market as standard MDF.

32 Therefore, the question to be considered is whether or not there is a separate market for MDF compared to a broader construction materials market. Some of the most common uses cited by the Applicant for MDF include commercial and domestic furniture, kitchens and joinery. A number of other applications were also mentioned, such as wall panelling, wall linings, and flooring. It should be noted that all MDF products are used for interior applications only.

33 The Commission was advised that particle board is the closest of the substitutes for MDF. Particle board is also used for interior applications only. The process of manufacturing particle board is broadly similar to that of manufacturing MDF except that the raw product is broken down into wood particles, rather than to the next stage of wood fibre as in MDF production. The process to make particle board is less energy intensive, and hence the production process is cheaper than that for MDF. The main disadvantage of particle board is that it does not offer the same high quality surface for a paint or lacquer finish, nor can it be as easily machined on its edge. However, particle board can be substituted for MDF in many applications, particularly when a laminated surface is added for kitchen cabinetry and shelving. Particle board is slightly less expensive than MDF.

34 Plywood, another potential substitute cited, may be used both externally and internally, and offers a good quality finish for the purposes of painting or polyurethaning. However the Commission has been advised that it is considerably more expensive than MDF or particle board, and therefore substituted with MDF sparingly.

35 During its investigation, the Commission was advised that while MDF, particle board and plywood are substitutable for each other in many of these interior applications, in general the substitution tends to be one way. In other words, while MDF can be substituted for particle board or plywood in almost all applications, the reverse is not the case. The Commission was advised that there were two main reasons for this. First, MDF can be painted or lacquered immediately to give a superior finish when compared to other wood-based panel products. Secondly, MDF can be machined on its edge, to create smooth or rounded edges, a result that is not possible with other wood-based panel products such as particle board.

36 The Commission was advised that the only application in which particle board is preferred to MDF is when it is used as flooring. It was explained that particle board is the preferred flooring product in New Zealand (other than concrete) because it has a greater tensile strength than MDF due to its larger wood particles, and thus offers greater durability. On the other hand, the Commission was also advised that a thicker grade of MDF would be sufficiently strong to be used as flooring. However, the use of a thicker grade of MDF for flooring would prove to be more costly than using particle board.

37 From the above discussion, it is clear that in some applications, MDF may be substituted for other wood-based construction products. However as discussed earlier, a number of factors including strength, price, finish and other aesthetics, limits the degree of substitutability.

38 The Commission recognises that there are some arguments available that would support a broader product market definition, such as the market for construction materials, which includes particle board and plywood. However, as discussed above, there are also arguments to support defining a market specific to MDF alone.

39 In the particular circumstances of this Application, the Commission proposes to adopt the Applicant's "narrow" market definition, and will define the product market as that

for MDF alone. In doing so it is noted that if there are no dominance concerns arising out of this narrow market, there are unlikely to be any dominance concerns within the wider market.

40 Accordingly, the Commission considers for the purposes of this Application that the relevant product market is that for MDF.

Wood fibre

41 As mentioned earlier, wood fibre in the form of wood chips is the basic input in the manufacture of MDF in New Zealand. It would appear that there is no close substitute for wood fibre as it is the fundamental input into the manufacture of MDF.

42 The Commission considers that the appropriate product market is that for wood fibre.

Geographic Market

MDF

43 Based on the information available, the Commission considers that the geographic extent of the MDF market is nationwide.

44 All four manufacturers of MDF in New Zealand sell MDF in both the North Island and the South Island, to both distributors and end users. In addition, the vast majority of MDF produced in this country is exported.

Wood fibre

45 The Applicant submitted that the market for the supply and acquisition of wood fibre is regional in scope. It pointed out that wood fibre is a low value, high volume product, with a relatively high proportion of transport costs to the total value of wood chips or logs. Because of this, wood processors tend to seek supply from forests or chip mills located within their own regions. The Applicant referred to a number of earlier Commission decisions on forestry including Decisions 224, 227 and 228, which identified nine geographic markets for logs in New Zealand. In the current Application, the Applicant states that it sees no reason for a change to the geographic dimensions previously adopted by the Commission.

46 In two more recent cases, Decisions 342 and 424, the Commission reconsidered the extent of the geographic market for logs. In Decision 342 (February 1999), it was argued that because log transport costs appear to have fallen in recent years, and there is some trade in logs in both directions between Nelson/ Marlborough and Westland, that the geographic market for wood supply should be extended to one wider market encompassing both regions. In a later case, Decision 424 (March 2001), the Commission again considered submissions to adopt a wider geographic market, being that for the purchase of pulp fibre in the whole of the North Island. However, in both cases, the Commission adopted narrow geographic markets, noting in the former case, that the cost of transport is still relatively high in relation to the value of logs, particularly for pulp logs and for unpruned saw logs. It also noted in the latter case that logs still tend to be processed on a regional basis, and that log and chip exports tend to pass through regional ports.

47 The Commission has discussed the extent of the geographic market for wood supply with the two other manufacturers of MDF, CTP and FWP, and both have stated that because of high transportation costs, all wood fibre supplied to their MDF plants is

purchased from forests in close proximity to MDF plants. CHH has stated that [ ]% of CTP's wood supply for its MDF plant is taken from within 50 kilometres of its plant in Rangiora.

48 The Commission considers that the relevant markets are likely to be geographically narrow and in relation to this Application are those for the supply/acquisition of wood fibre in Nelson/Marlborough and Otago/Southland.

Functional Market

<u>MDF</u>

49 The appropriate functional level appears to be that for the manufacture and supply of MDF.

<u>Wood fibre</u>

50 The appropriate functional level appears to be that of the acquisition and supply of wood fibre.

Conclusion on Market Definition

51 The Commission considers that for the purposes of this Application, it will adopt the following markets:

- the national market for the manufacture and supply of MDF, and
- the regional markets (Nelson/Marlborough and Otago/Southland) for the supply/acquisition of wood fibre, ("the wood supply market").

COMPETITION ANALYSIS

Introduction

52 The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of dominance.

The Dominance Test

53 Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

54 Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a

> dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
>
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

55 The test for dominance has been considered by the High Court. McGechan J stated:[3]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

56 Both McGechan J and the Court of Appeal, which approved this test,[4] stated that a lower standard than "a high degree of market control" was unacceptable.[5] The Commission has acknowledged this test:[6]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

57 The Commission's *Business Acquisitions Guidelines* state:

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor {or} customer reaction."
>
> …
>
> "A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability." (p21)

58 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

59 The Commission applies the dominance test in the following competition analysis.

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[3] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)

[4] *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)

[5] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC) and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)

[6] *Business Acquisition Guidelines*, Section 7

The Market for MDF

Market Concentration

60 An examination of concentration in a market often provides a useful first indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

61 The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

62 These safe harbours recognise that both absolute levels of market share, and the distribution of market shares between the merged firm and its rivals, is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state (at page 17) that:

> "Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours."

63 Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

64 In this case, market shares have been assessed in two ways. First, the Commission has obtained the total sales volumes of MDF, both exported and sold domestically from each of the four MDF manufacturers in New Zealand for the last two years, or twelve month periods[7]. Secondly, the Commission has sought production capacity from each of the four manufacturers. In order to ensure a standardised measure of production capacity across all four competitors, the Commission requested that the manufacturers express their capacity in terms of how much 16 or 18 millimetres MDF they could produce in any one year.

65 On the basis of the information provided by the Applicant and each competitor, the Commission has determined the respective market shares in relation to sales volumes (both export and domestic) and production capacity, as shown in Tables 1 and 2:

[7] CTP advised it measured its sales volumes for the year to March , while FWP measures its sales volumes for the year to June.

Table 1

Total MDF Sales Volumes in Cubic Metres

	1999[8] m^3	%	2000[9] m^3	%
NPIL	[ ]	[ ]	[ ]	[ ]
Rayonier (incl sales volume to FWP)[10]	[ ]	[ ]	[ ]	[ ]
Merged Entity	[ ]	[ ]	[ ]	[ ]
FWP (excl Rayonier)	[ ]	[ ]	[ ]	[ ]
CTP	[ ]	[ ]	[ ]	[ ]
Total	**702,978**	**100.0%**	**785,845**	**100.0%**

Table 2

Current Estimated Annual Production Capacity (For Standard MDF) in Cubic Metres

	Capacity if all standard MDF m^3	%
NPIL	400,000	42%
Rayonier	170,000	18%
Merged Entity	570,000	60%
FWP (excl Rayonier)	160,000	17%
CTP	220,000	23%
Total	950,000	100%

66 On the basis of the above figures, the merged entity's market share expressed in terms of sales volumes would be [ ]% and in terms of production capacity for standard MDF, 60%.

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[8] CCH and FWP advised that these figures relate to the years ended March 2000 and June 2000 respectively.
[9] CCH and FWP advised that these figures relate to the years ended March 2001 and June 2001 respectively.
[10] [

]

67 Therefore the merged entity's market share falls within the "safe harbours" discussed at paragraph 61 in terms of sales volumes and is just on the safe harbours when production capacity for standard MDF is considered.

68 However, as stated earlier, market shares are only one of the factors considered in assessing whether the acquisition will result in the merged entity gaining or strengthening a dominant position in a market. Additional factors must also be considered before a conclusion on dominance is reached. These other factors are discussed below.

Existing Competition

69 FWP has five wood-based panel production sites in New Zealand and one in Brisbane. FWP operates its MDF facility at Taupo, producing MDF boards that are sold under the brand name "Lakepine." FWP has another plant in Hamilton that applies an impregnated paper to the top and bottom surfaces of the MDF boards it produces at its Taupo MDF plant. This product is sold under the brand name "Meltica."

70 The nameplate capacity of its Taupo MDF plant is 160,000 cubic metres per year. FWP advised that it is currently running this plant at about [ ] of its capacity, with production of between [ ] cubic metres per year. A limitation of this plant is that due to the age of the technology used, it can only make MDF of nine millimetres thickness and above. The other three manufacturers of MDF in New Zealand are able to produce the full range of thicknesses, including thin boards of less than nine millimetres. For this reason, FWP has entered into a contract with Rayonier to produce a thin MDF board to FWP's specifications, which is then marketed under FWP's brand name "Lakepine." [ ]

71 FWP explained that its ease of ability to increase capacity at its MDF plant depended on what level of production capacity the plant was running at. The production lines are able to be operated 24 hours a day and the plant can be staffed accordingly. In order to increase capacity, FWP needs to organise the supply of extra raw materials and ensure it has sufficient trained staff. It has stated that it can organise additional raw material with [ ] notice, and if necessary recruit and train additional staff within [ ] months. At present, with the plant running at [ ] of capacity, the only inputs needed to increase production are raw materials, such as resin and wood supply. FWP added that for [ ] months of the year 2000, its plant was operating at [ ]

72 FWP explained it is not technically possible for its particle board plants to switch to the production of MDF. FWP estimated that the cost of building a completely new production line at its existing MDF plant could be up to [ ], but that alterations could be made to its existing production line to increase capacity at a cost of about [ ].

73 FWP was asked what its likely competitive response would be if the merged entity were to increase its prices by a *ssnip*, as explained in paragraph 24 of this report. FWP explained that if this were to happen, there would be no impediment to it being able to direct more of its product into the domestic market, and it would move quickly to take the opportunity to increase its domestic market share. FWP went on to state that it viewed New Zealand as a very price sensitive market and that even a 1% price increase, if not followed by others, would be resisted by purchasers. FWP said it had been in the position of having to reverse price increases it had made in the past because of such

resistance from purchasers. FWP pointed out that its ability to respond competitively if the merged entity were to increase the price of the thin MDF board (which currently Rayonier produces for FWP under contract) was limited, as the only other option for supply would be CTP, owned by CHH.

74 CHH owns a number of wood-based panel production sites in both New Zealand and Australia, purchasing a large Australian MDF plant 12 months ago. This plant has a capacity of [ ] cubic metres per year. Its New Zealand plant is situated at Rangiora, north of Christchurch, and has a capacity of about [ ] cubic metres per year. In 1995, a new production line was added to the Rangiora plant, enabling the plant to manufacture the whole range of MDF products, including thin board.

75 CHH stated that, in the event of the merged entity applying a "*ssnip*" to the New Zealand MDF market, CTP would have no difficulties in increasing its supply to the domestic market. CHH said it would look at its most marginal export market and compare it to the prices it could gain on the New Zealand market ex-plant. It if were more profitable to supply to the New Zealand market, it could easily switch to that market. CHH pointed out that in comparison to the other export markets in which it was selling MDF, the New Zealand domestic market is very small, and any extra demand could easily be supplied by its Australian MDF plant, which is running at about [ ] capacity at present.

76 CHH pointed out that in relation to the supply of thin MDF, it would be easy in principle for CTP to devote one of its Rangiora plant lines entirely to the production of thin MDF for one week, and this would be sufficient to provide all New Zealand's yearly consumption of thin MDF.

77 Both FWP and CHH described MDF as an international commodity product, where import parity pricing is used. Both confirmed that pricing has been very stable over the last five years or so, with only one recent price increase occurring earlier this year.

78 At present, total domestic consumption of MDF is around 115,000 – 120,000 cubic metres per year, whereas total annual production in New Zealand is around 700,000 cubic metres. As shown in Table 2, total New Zealand capacity is estimated as 950,000 cubic metres per year, if only standard MDF was manufactured. Therefore, any increased demand in the domestic market could easily be supplied by the existing New Zealand plants. In addition, the Commission was advised that Australian MDF manufacturers have a combined national capacity of around 900,000 cubic metres annually, and these manufacturers could also easily supply any increased demand in New Zealand.

Conclusion on Existing Competitors

79 The Commission is satisfied that the constraint by the other MDF manufacturers will prevent the merged entity from acquiring or strengthening a dominant position in the market.

Constraint from Potential Competition

80 The Applicant states that significant investment would be required for an overseas MDF manufacturer to set up an MDF plant in New Zealand. It estimates that the cost of this is likely to be in the order of NZ$120 – $130 million. It suggests that the large volumes of wood supply that are about to come on stream in New Zealand may be attractive to overseas manufacturers, but adds that the substantial investment required is only likely

to occur in response to an increase in the international demand for MDF. FWP submitted that the cost of building a new plant on a new site would be about NZ $100 million and the costs of complying with environmental concerns would need to be added to that.

81 The Applicant estimates that it would take 18-24 months for a “greenfields” site to be established. CHH and FWP agree that this is a reasonable estimate of how long it would take to build and commission a plant. However both CHH and FWP estimated that the time involved in obtaining approval under the Resource Management Act could easily add at least a further 12 months to this time span.

82 Raw and laminated MDF products are now, or have been in the past, imported into New Zealand from several manufacturers in Australia, along with Malaysian and Indonesian manufacturers. The Commission received a range of views from manufacturers and distributors on the competitive constraint offered by imported MDF coming into New Zealand. CHH stated that in its view, if MDF prices in New Zealand were to rise by 5 -10%, the Australian manufacturers would have no hesitation in exporting product to New Zealand. FWP stated that while it saw no impediments to imports, it considered that brand reputation was also very important to New Zealand consumers.

83 One of the distributors spoken to during the investigation had imported MDF from Australia for four of the last five years. On the other hand, some of the distributors viewed the possibility of imports as an unattractive option because of logistical issues including warehousing, inventory and distribution costs associated with this option. A number of these distributors expressed a preference for continuing to deal with New Zealand produced MDF, although they acknowledged that imports remain an option.

<u>Conclusion on Potential Competition</u>

84 The Commission does not consider that new entry is likely and therefore it is not satisfied that the constraint provided by the threat of such entry would be sufficient to constrain the merged entity. However the possibility of imports is present and this could provide some constraint to the merged entity.

Countervailing Power

85 The Applicant states that the acquirers of MDF would act as a significant constraint on the merged entity. It added that the wholesale distributors who currently purchase MDF from either NPIL or Rayonier could easily switch to purchasing from the other MDF producers, CTP or FWP.

86 Most MDF sold on the domestic market is purchased by either the wholesale distributors or some of the large end-users such as furniture and kitchen manufacturers.

87 The Commission has spoken to almost all of the major wholesale distributors and several of the large end-users that purchase MDF from the manufacturers. The Commission’s enquiries have confirmed that the acquirers are in a sufficiently strong position to prevent the merged entity from unilaterally raising the price of MDF without losing significant market share. These acquirers have confirmed that MDF is treated as a commodity product that is particularly price sensitive, and that they are quite prepared to shift their custom to the alternative manufacturers if market conditions change. While some of the distributors have preferred supplier agreements in place, none have exclusive supplier contracts or agreements with the MDF manufacturers.

88 For example, Mitre 10, a distributor with about 120 stores nationwide, currently has a preferred supplier arrangement with NPIL. Representatives from Mitre 10 said that due to the commodity nature of MDF, it would be very difficult for any of the manufacturers to raise their prices in isolation and retain customers. Their view was that the market would be very sensitive to a 5% increase in price and would react by switching to an alternative supplier or suppliers.

89 Benchmark Building Supplies, an Australian owned company, purchases MDF from both CTP and NPIL. It said that all of the MDF manufacturers, including NPIL, know that they have to remain price competitive to retain custom. Representatives from Benchmark said that if the merged entity raised the price of MDF, Benchmark would obtain its MDF from the other domestic manufacturers or look to import MDF directly from Australia.

90 Placemakers, a national distributor which is 50% owned by FBL and 50% owned by individual operators under a franchise agreement, purchases MDF from all of the MDF manufacturers. Although it purchases the majority from FWP, it uses the prices offered by the other manufacturers as leverage to ensure that the prices from FWP are competitive. Representatives from Placemakers stated that a manufacturer could only raise its price by 5% if it was prepared to lose market share.

91 Carters, wholly owned by CHH, mainly sources its MDF from CTP, but also sources small amounts from both FWP and NPIL. Carters said that it was unlikely that one of the MDF manufacturers could push through a price increase without good justification. It said that if a manufacturer did this, an alternative supplier would be sought.

Conclusion on Countervailing Power of Purchasers

92 The Commission is satisfied that the constraint provided by MDF purchasers would be sufficient to prevent the merged entity from acquiring a dominant position in the market.

Overall Conclusion on the National Market for the Manufacture and Supply of MDF to Distributors and End-users

93 The Commission is satisfied that the if the proposed acquisition were to proceed, the merged entity would not, and would not be likely to, acquire or strengthen a dominant position in this market due to the constraint provided by existing competitors, potential imports and the countervailing power of purchasers.

The Market for the Acquisition and Supply of Wood Fibre in Nelson/Marlborough and Otago/Southland

94 The Applicant states that it purchases its wood fibre from various forest owners in the Nelson/ Marlborough region. Likewise, Rayonier purchases its wood fibre from forest owners and wood dealers within the Southland/Otago region, including from Rayonier Inc owned forests. Therefore, NPIL and Rayonier acquire the wood fibre for their respective MDF facilities from either end of the South Island.

95 The Applicant states that if the acquisition proceeds, it proposes to continue to source all wood fibre for the Mataura plant from the Southland/Otago region. The Applicant

submitted that it is most unlikely that there will be any aggregation of the merged entity's activities as an acquirer of wood fibre in either of the discrete regional markets identified earlier, that of Nelson/Marlborough and Otago/Southland.

96 The Commission's enquiries with various wood dealers and forest owners in the two regions identified have confirmed that the proposed acquisition is unlikely to have any effect on the current situation with regard to the wood supply markets concerned.

97 Furthermore, the Applicant has submitted that no vertical integration between its forestry and processing activities would result if the proposed acquisition proceeds. The Applicant is not involved in the supply of wood in the Southland/Otago region so there would be no vertical integration of the Mataura facility with its current interests and involvement in wood supply in the Nelson region. It points out that the sale of the Mataura MDF plant to NPIL would remove the existing vertical integration between Rayonier's forestry and processing operations.

Overall Conclusion on the Market for the Acquisition and Supply of Wood Fibre in Nelson/Marlborough and Otago/Southland

98 The Commission is satisfied that the if the proposed acquisition were to proceed, the merged entity would not, and would not be likely to, acquire or strengthen a dominant position in this market. This is due to the fact that the wood fibre markets affected by the proposal are regional in nature and no aggregation would occur in these markets if the merger were to proceed.

OVERALL CONCLUSION

99 The Commission has considered the impact of the proposed acquisition in the following markets:

- the national market for the manufacture and supply of MDF, and
- the regional markets (Nelson/Marlborough and Otago/Southland) for the supply/acquisition of wood fibre, ("the wood supply market").

100 Having regard to the factors set out in section 3(9) of the Commerce Act, and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

101 Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to Nelson Pine Industries Limited or any of its interconnected bodies corporate to acquire up to 100% of the shares in Rayonier MDF New Zealand or all of the medium density fibreboard processing assets and business of Rayonier and/ or any of its interconnected bodies corporate at Mataura.

Dated this 31st day of May 2001

M J Belgrave
Chair