



COMMERCE COMMISSION

Decision No. 733

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

MATARIKI FORESTS

and

SELWYN PLANTATION BOARD LIMITED

- The Commission:** Mark Berry
Pat Duignan
Anita Mazzoleni
- Summary of Acquisition:** The acquisition by Matariki Forests (or an interconnected body corporate) of the Canterbury forestry assets of Selwyn Plantation Board Limited.
- Determination:** Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Matariki Forests to acquire the Canterbury forestry assets of Selwyn Plantation Board Limited.
- Date of Determination:** 28 September 2011

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SQUARE BRACKETS**

THE PROPOSAL

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 22 June 2011. The Notice sought clearance for Matariki Forests (Matariki or the Applicant) to acquire the Canterbury forestry assets of Selwyn Plantation Board Limited (SPB).

PROCEDURE

2. Section 66(3) of the Act requires the Commission to either clear or decline to clear the acquisition referred to in a s 66(1) notice 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 Matariki. Accordingly, a decision on the application was required by 28 September 2011.
3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

THE DECISION

4. The Commission considers the relevant markets for this application are:
 - the production and supply of pulp logs in mid and north Canterbury for the period 2012-2018.
 - the production and supply of L-grade logs in mid and north Canterbury for the period 2012-2018; and
 - the production and supply of S-grade logs in mid and north Canterbury for the period 2012-2018.
5. The Commission considers that in the markets for pulp logs and L-grade logs, competition from forestry managers/consultants along with some constraint provided by the countervailing power of log processors is likely to be sufficient to constrain the combined entity. In the market for S-grade logs, competition from forestry managers/consultants along with some constraint provided by the level of competition in the Canterbury region for finished timber produced from S-grade logs is likely to be sufficient to constrain the combined entity. Accordingly, the Commission is satisfied the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

ANALYTICAL FRAMEWORK

6. The Commission uses an analytical framework for assessing a substantial lessening of competition in the context of an acquisition. The first step is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target, and then considers what, if any, products and geographic regions, constitute relevant close substitutes from both a customer's and a supplier's point of view.
7. The Commission uses a forward-looking type of analysis to assess whether a substantial lessening of competition is likely, so 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

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

- in the absence of the acquisition (the counterfactual).
8. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.²
 9. A comparison of the extent of competition in the relevant markets in the factual and counterfactual scenarios enables the Commission to assess the probable extent of the lessening of competition under the proposed acquisition, and whether that contemplated lessening is likely to be substantial.

KEY PARTIES

Matariki

10. Matariki is ultimately owned by:
 - Phaunos Timber Fund, a United Kingdom-based forestry investment fund (35%)³;
 - Rayonier Inc (Rayonier), a Florida-based investment trust owning and managing forests in the United States and New Zealand (26%);
 - AMP Capital Investors (23%); and
 - SAS Trustee Corporation, a New South Wales superannuation fund (16%).
11. Matariki is the third largest owner of New Zealand forests. Rayonier is both a shareholder in Matariki and its subsidiary Rayonier New Zealand is Matariki's forest manager. Matariki is the major exotic forest owner in mid and north Canterbury. It owns Eyrewell, Ashley, Okuku, Mount Thomas, Omihi, Oxford, Balmoral and Hamner Forests. These forests are predominantly situated on land owned by Ngai Tahu with forestry rights attached. Ngai Tahu is currently converting the Eyrewell and Balmoral Forests to land uses other than forestry. This will substantially reduce Matariki's future log production in Canterbury.
12. During the year ended 31 May 2011, Matariki's production from its 9908 hectare Canterbury forest estate was about [] tonnes of logs. This volume comprised [] tonnes of pulp logs and firewood [], [] tonnes of export logs [] and [] tonnes of unpruned sawlogs for local processing [].⁴ Export logs from Matariki's forests are exported on its behalf by Rayonier New Zealand.
13. Of Matariki's unpruned sawlogs processed in local sawmills, about []% were industrial grade logs⁵ processed by SRS Ltd to produce pallets and other packaging timbers and knot free finger jointed timber.⁶ The balance were structural grade sawlogs processed by seven mid-Canterbury sawmills for use as structural timber for house framing and outdoor structures.
14. Matariki states that the rationale for its acquisition of SPB is to compensate for its reduced production over the next 10 years caused by its hand back of productive land to Ngai Tahu.

² *Decision No. 277: New Zealand Electricity Market*, 30 January 1996, p 16.

³ Phaunos Timber Fund paid NZ\$167 million for its share of Matariki in February 2010.

⁴ The percentages quoted are those of Matariki's total log production from its Canterbury forests. The [] balance of Matariki's production was pruned sawlogs and posts and poles.

⁵ See below for a description of log grades.

⁶ One other structural sawmill processes a very small volume of industrial grade logs in comparison to its total log input.

Selwyn Plantation Board (SPB)

15. SPB is ultimately owned by the Selwyn District Council (60.68%) and the Christchurch City Council (39.32%). It owns forests in the Malvern Foothills of the Southern Alps located between the Waimakariri and Rakaia Rivers and on the coastal sand country located immediately to the north of Christchurch City. SPB owns the Malvern Hill forest land but leases the sand forest land from the Christchurch City Council. Its forests are managed by forestry consultant/manager, P F Olsen.
16. During the year ended 31 May 2011, SPB's production from its 4,600 hectare forest estate was about [] tonnes. This volume comprised [] tonnes of pulp logs and firewood [], [] tonnes of export logs [] and [] tonnes of unpruned sawlogs [].⁷ SPB is the second largest exotic forest owner in the region. Export logs from SPB's forests are sold to and exported by Tenco Limited (Tenco).
17. SPB informed the Commission that its log production during the year ended 31 May 2011, was [] tonnes. SPB estimates sustainable long term log production from its estate is about [] tonnes per annum (tpa).
18. Of SPB's unpruned sawlogs which were processed in local sawmills, about [] were industrial grade logs processed by SRS Ltd as above. The balance were structural grade sawlogs processed by the mid-Canterbury sawmills.

OTHER PARTIES

Forestry Consultants/Managers

19. Matariki and SPB are the only two "corporate" forest owners in the region. The other major source of log supply is from woodlots and shelter belts⁸ usually managed by forestry consultant/managers. Forestry managers on behalf of the land owners may organise some or all of the following:
 - planting the woodlot;
 - any necessary silviculture;
 - harvesting and recommendations regarding sale to either export or local processors; and
 - transportation to port or processors.

PF Olsen

20. PF Olsen Ltd is a forestry consultant/manager, which administers day to day operational forest activities for individual and corporate clients throughout New Zealand. PF Olsen manages SPB's forests and exotic woodlots in Canterbury. It also supplies logs to local sawmills, to Daiken NZ Ltd, and to Tenco for export.

⁷ Again, the percentages quoted are those of SPB's total log production and the [] balance of SPB's production was pruned sawlogs and posts and poles.

⁸ Shelter belts, farm forestry and small forests will be referred to under the generic name "woodlots." If a woodlot is defined as being up to 500 hectares in area, according to the Ministry of Agriculture and Forestry's National Exotic Forests Description paper, April 2010, there are about 195 such woodlots of varying ages in Canterbury.

Forest Management Limited (FML)

21. FML is also a forestry consultant/manager. It manages exotic woodlots in Canterbury on behalf private owners and other organisations such as Environment Canterbury. FML has 7000 – 8000 hectares of privately owned woodlots under management in Canterbury and is the largest of the woodlot managers in the region.
22. FML supplies logs to local sawmills and to Daiken NZ Ltd. FML also holds the lease of a log storage area at the Port of Lyttelton which is necessary for the efficient export of logs produced in Canterbury. Rayonier, Matariki's manager is the exporter and FML has a contract with Rayonier to supply export logs (in addition to those from Matariki's forests).

Trans Tasman Forestry Limited (Trans Tasman)

23. Trans Tasman is a forestry consultant/manager based in Canterbury. Trans Tasman manages exotic woodlots on behalf of their owners. Trans Tasman supplies logs to local sawmills, to Daiken NZ Ltd, and to both Rayonier and Tenco for export.

Laurie Forestry Limited (Laurie)

24. Laurie is also a forestry consultant/manager based in Canterbury. Laurie manages exotic woodlots on behalf of their owners. Laurie supplies local sawmills, Daiken NZ Ltd and Tenco.

Other Log Suppliers

25. In addition to Matariki, SPB and the above list of forestry consultant/managers, there is a small amount of logs supplied into Canterbury from the West Coast. Export logs from the West Coast are delivered to Lyttelton by rail and sawlogs (about 140 tonnes per week) are available to Canterbury processes but only if a back load is available.⁹
26. In addition, it appears a small quantity of logs are sourced from woodlots in Canterbury by woodlot logs sellers contracting directly with sawmill purchasers.

Blakely Pacific Limited (Blakely)

27. Blakely is a large forest owner in South Canterbury, owning approximately 13,300 hectares of forests at its Geraldine, Raincliffe, Saddlepeaks, Waimate, and Pentland Hills forests.¹⁰
28. Blakely exports [] of its log production, mostly through the Port of Timaru. The balance is supplied to several small sawmills in South Canterbury and North Otago and, as noted above, to SRS Ltd's sawmill at Rolleston as industrial grade logs. It does not supply structural grade logs to the mid Canterbury processors. The distance between Geraldine Forest and Christchurch International Airport¹¹ is 156 kilometres. Steve Murphy Ltd, a Kaiapoi transport operator advised that the log transport rate for this journey is [] per tonne.

Sawmills and Medium Density Fibreboard (MDF) Mill

29. In mid-Canterbury seven sawmills produce structural grade timber from structural grade logs (S grade) supplied from the forest and woodlots in the region. A further sawmill (SRS Ltd) produces industrial timber products from industrial grade logs (L grade) supplied from the forests and woodlots in the region.

⁹ Backloads from the West Coast to Canterbury result from the low volumes of pruned sawlogs which are supplied from Canterbury forests and woodlots to specialist West Coast sawmills.

¹⁰ Canterbury Forest Industry and Wood Availability Forecasts (MAF) - 2007

¹¹ Christchurch International Airport is the approximate centre of the mid-Canterbury log processors.

30. In addition to these sawmills, Daiken NZ Ltd operates an MDF mill near Rangiora which purchases pulp logs from local forest and woodlot owners and wood chips from sawmill owners.
31. The structural timber sawmills in Canterbury are all small to medium sized operations producing a maximum of 40,000 m³ per year of timber each. The majority of structural timber used in Canterbury is supplied by Carter Holt Harvey Limited and Red Stag from sawmills outside the region.
32. Canterbury processors have a narrow focus on the purchase of either S grade logs for the production of structural timber or, in the case of SRS Ltd, in the purchase of L grade logs for the production of industrial timber,¹² or in the case of Daiken NZ Ltd in the purchase of pulp logs for the production of MDF.
33. Sawmills producing structural grade timber in mid and north Canterbury include:
- McAlpines Timber Ltd (McAlpines);
 - McVicar Timber Group Ltd (McVicar);
 - Mitchell Brothers Timber Ltd (Mitchell);
 - Stoneyhurst Timber Ltd;
 - Selwyn Sawmills Ltd;
 - Sutherland Timber Co Ltd; and
 - Ashburton Timber Co (1990) Ltd.
34. As discussed, Daiken NZ Ltd produces MDF from pulp logs (which it chips) and from wood chips produced from wood waste by local sawmills. Daiken processes about [] tpa of pulp logs and a further [] tpa of woodchips purchased from local sawmills. Daiken NZ Ltd is the only Canterbury purchaser of pulp logs and wood chips.
35. SRS Ltd processes about [] tpa of L-grade logs. SRS Ltd obtains its logs from a mix of all the log suppliers listed above as well as a small amount [] tpa) from Blakely's forest near Geraldine. These are the only logs that Blakely Pacific supplies to the mid Canterbury processors. Blakely informed the Commission that it receives less revenue from these sales than from other local or export sales due to the cost of transport from South Canterbury to Rolleston (about [] per tonne). []

Steve Murphy Ltd (SML)

36. SML is a transport company based in Kaiapoi that specialises in transporting logs and also woodchips in Canterbury. SML is the largest log transport provider in Canterbury.

Frews Transport Ltd (Frews)

37. Frews is a general transport contractor based in Darfield that transports logs from SPB's estate and other forestry owners to the mid Canterbury processors and to the Port of Lyttelton.

¹² As discussed above there is one minor exception to this narrow focus rule. [] purchases [] of its log supply as L grade logs.

Underbidders

[]

38. [] was the original winning tenderer but it failed to execute the sale and purchase agreement. [] New Zealand agent informed the Commission that [] owns several forests in China but that it does not have significant processing facilities in China or anywhere else. [] agent stated that it would continue to sell higher grade logs to local processors.

39. Once the [] tender failed, SPB invited selected tenderers from the first round to submit a second offer.

[]

40. [] was an underbidder to Matariki for the purchase of SPB in the first round of tenders carried out by SPB's owners.¹³ []

41. [] informed the Commission that had it been successful in winning the tender for SPB, it would have continued to supply the local processors as that would have been a more profitable strategy than exporting those logs. It said that domestic prices were stable in comparison to volatile export prices providing greater returns over time from those logs suitable for local processing.

[]

42. In the second round, the underbidder to Matariki was []. [] has no processing facilities and stated to the Commission that it would continue to sell higher value structural logs to local processors.

Log Exporters

43. There are two log exporters operating from the Port of Lyttelton. One is Matariki's forest manager and shareholder, Rayonier, which exports Matariki's logs. It also has an export log supply contract with FML. Rayonier exports [] % of the logs passing through the Port of Lyttelton.

44. The other exporter of mid and north Canterbury logs is Tenco. Tenco and PF Olsen have an export log supply relationship. Tenco exports [] % of local exports.

Woodlots

45. The Canterbury region is unusual in respect of the higher than average ratio of log production from woodlots to total log production. The reason for this high proportion is that the Canterbury plains are generally better suited to agriculture or pastoral farming than forestry. However there is also a need for some forestry to provide shelter belts and also river bank stabilisation. Therefore many individual farmers have invested in woodlots.

46. In Canterbury over 50% of the woodlots are 100 hectares in area or larger.¹⁴ SML, which has experience in the Canterbury forest industry since the 1970s, advised the Commission that there was a large wind storm in 1975 which severely damaged forests and woodlots in Canterbury. Following that "windthrow" woodlot growing practises in Canterbury changed. From that time onwards, there was a move towards the planting of woodlots in

¹³ The present sale and purchase agreement negotiated between SPB's owners and Matariki derived from a second tender round, necessitated by the winner of the first round not following through with necessary commitments to the purchase.

¹⁴ Source: MAF's National Exotic Forest Description, 1 April 2010.

sizable blocks that had good silviculture practices applied to them. These woodlots are now producing similar proportions of good quality S-grade logs as do corporately owned forests.

47. Secondly, forestry consultants/managers moved into the management of woodlots on behalf of their owners. Examples are PF Olsen, FML, Laurie Forestry and Trans Tasman Forestry mentioned above. The aggregation of log production from their woodlots under management by the forestry consultants/managers resulted in log supply from woodlots at a more constant level year round. During winter, forestry consultants arrange to harvest from easier to access blocks with the reverse occurring in summer when ground conditions are firmer.
48. Given the large number of woodlot holders in Canterbury, the Commission considers that their overall harvest patterns are relatively stable. While industry participants have stated that individual woodlot holders are less predictable than corporate, with regard to the timing of harvesting, the forestry consultant aggregating factor means that their total production can be smoothed out.
49. According to MAF, in the whole of Canterbury there are 178 forest owners whose woodlots are larger than 40 hectares (excluding Matariki, SPB and Blakely). The Commission has used a factor of 0.75 to determine that there are 134 large woodlot owners in mid and north Canterbury.¹⁵
50. There was a substantial quantity of new woodlot planting in Canterbury beginning in the mid to late 1980s. This means that there will be a substantial rise in log production from woodlots in Canterbury from 2017 onwards as these trees reach 30 years old.

Industry Background

51. Exotic plantation forests in Canterbury are concentrated in the areas to the North and West of Christchurch within a radius of 100km from Christchurch airport. While there is some plantation forestry on the Canterbury Plains, the most productive forestry land is located in the foothills of the Southern Alps. The most significant forests are Eyrewell, Balmoral, Ashley, and Hamner forests owned by Matariki and those of SPB located in the foothills behind Darfield.
52. Smaller privately owned woodlots are situated throughout the region. These forests are owned by investors, land owners and farmers. As noted above, there are also significant exotic plantation forests in South Canterbury owned by Blakely Pacific.
53. The quality of logs is influenced by several factors: genetic selection, silviculture practice (pruning and thinning), site features (eg contour, soil quality, rainfall and susceptibility to wind) and rotation age. The end use of logs depends on their individual grade. This is a function of:
 - size being diameter and length;
 - shape being straightness (sweep), roundness and taper; and
 - branch related features such as knot size and distribution.
54. Logs are initially graded according to whether they are pruned, unpruned or pulp logs. Very few pruned logs are produced in Canterbury. Pulp logs are those suitable for chipping rather than the production of sawn timber. Pulp logs are usually those cut from the upper lengths of individual trees.

¹⁵ A factor with which Matariki concurs.

55. The Ministry of Agriculture and Forestry ('MAF') website provides generic product specifications and prices for domestic and export grade logs hows the product specifications for domestic unpruned log grades as identified by MAF.

Table 1: Domestic Unpruned Log Grades (Forest Research Specification)

Log Grade	Log status	Small end Diameter (mm)	Maximum Knot (mm)	Sweep class
S1	Unpruned	400+	60	1
S2	Unpruned	300-399	60	1
S3	Pruned or unpruned	200-299	60	1
L1	Unpruned	400+	140	1
L2	Unpruned	300-399	140	1
L3	Unpruned	200-299	140	1

Source: MAF website

56. The letter used in the grading signals the quality of the log, which is measured by the characteristics specified in Table 1, as well as the density of the wood fibre. MAF categorises structural logs (or 'S-grade logs') into three standard log grades, those being S1, S2, and S3 (which are differentiated according to the size of the log). Similarly, industrial logs (or 'L-grade logs') are separated into three grades, those being L1, L2, and L3. Log sellers sometimes label structural logs according to their small end diameter ('SED'). For example S 30 is equivalent to S2 (30 denoting a small end diameter of 30cm), and S40 is equivalent to S1.

57. Table 2 shows the product specifications for export log grades as identified by MAF.

Table 2: Export Unpruned Log Grade Specification¹⁶

Log Grade	Small end Diameter (mm)	Maximum Large end Diameter (mm)	Maximum Knot size (mm)	Length (m)	Percentage allowed	Sweep
Japan A	200-340	800	d/3 up to 150 mm max	4.0	10% max	d/4
			Excessive number of large knots not permitted	8.0	balance	d/2
				12.0	50% min	d
Japan J	200-260	No limit	d/3 up to 150 mm max	4.0	10% max	d/4
			Excessive number of large knots not permitted	8.0	balance	d/2
				12.0	50% min	d
Korea K	200-260	No limit	d/3 up to 150 mm max	3.6	balance	d/4
			Excessive number of large knots not permitted	5.4	10% max	d/4
				7.3	balance	d/2
				11.0	40% min	d

Source: MAF website

58. As is evident from Tables 1 and 2, logs are graded based on a number of characteristics. For example, MAF considers that export grade logs can have knots of up to 150mm in diameter, whereas domestic structural logs cannot have knots greater than 60 mm in diameter.
59. Industry participants stated that an A-grade export log is a high grade export log and that some A-grade logs would also qualify as S-grade logs if processed domestically. Historically S-grade logs have generally had a higher value, however if A-grade logs have a higher value, as has been the case for much of the past 12 months then S-grade logs may be exported as A-grade.
60. Acoustic velocity measuring equipment (known as "Hitman") developed within the past five to 10 years assists the grading of logs by both suppliers and users. The Hitman has the

¹⁶ Significant volumes of industrial sawlogs (KI grade) are also exported. The small end diameter of these logs is greater than 280mm with maximum knot size of up to 250mm.

ability to accurately calculate a log's density and hence predict its strength properties when sawn into timber.

61. Although log grading in forests still essentially is carried out by visual inspection of dimension and knot properties, the Hitman is a useful tool for processors to provide them with confidence (pre-processing) that the grade of logs for which they are paying forest owners will provide correct specification strength timber.

PREVIOUS COMMISSION DECISIONS

62. The Commission most recently considered log markets in Decisions 342, 588 and 589. The Commission also previously considered log markets in similar circumstances in Decision 342.
63. In Decision 342, *RII Weyerhaeuser World Timberfund LP (Weyerhaeuser) and Carter Holt Harvey Limited (CHH)*, February 1999, the Commission concluded that the relevant market was that for the supply of logs in Nelson /Marlborough.
64. Decision 342 was assessed under the dominance test. The Commission considered that the acquisition would result in Weyerhaeuser acquiring a dominant position in the market. At the time of the decision, Weyerhaeuser's market share was in the order of 58% while CHH's was around 26%, giving a combined market share of around 84%. Apart from Weyerhaeuser and CHH, there were no significant log suppliers in Nelson Marlborough; the next largest supplier (Rayonier) had a market share of around 4%. The Commission also considered that log buyers had limited countervailing power due to the level of competition for the supply of timber from outside the region. The Commission therefore declined the application.
65. In Decision 588, *Hancock Natural Resource Group Inc and Carter Holt Harvey Limited* September 2006, and Decision 589, *CBRF Limited and Carter Holt Harvey Limited*, October 2006, the Commission determined that there were separate product markets for pruned sawlogs, unpruned sawlogs and pulp logs and also that it was appropriate to define distinct timeframes within the relevant markets in the next few years after the decision.
66. The Commission granted clearance to those acquisitions on the basis of constraints from existing competition (log supply from other corporate forests and from woodlots and the countervailing power of log purchasers).
67. In Decision 602, *Carter Holt Harvey Limited and Lakesawn Lumber Limited* May 2007, the Commission determined that there is a separate product market for the purchase of structural logs. The Commission considered that forest owners would, under normal market conditions, be unlikely to divert logs with structural qualities to the domestic industrial log market, or to export markets in response to a SSNIP and that sawmills set up to produce structural timber have a strong preference for structural logs.
68. The Commission gave clearance to that acquisition on the basis that Lakesawn Lumber Limited would face constraints from the potential for expansion by other nearby sawmills which would sufficiently constrain Lakesawn.

MARKET DEFINITION

69. The Act defines a market as:¹⁷

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.

70. 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 entry would 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 dimensions of the market 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.

71. The Applicant submitted that the Commission has a well developed approach to market definition in respect of the forestry industry, and accepts the Commission's previous analysis of the relevant market dimensions. Matariki submitted that the relevant markets are similar to those defined in decisions 588 and 589 and are the Canterbury and West Coast (or alternatively the Canterbury alone) regional markets for the production and supply of pulp logs and unpruned sawlogs for each of the time periods 2012-2015, 2016-2029.

Product Markets

72. The greater the extent to which one good or service is substitutable for another, on either the demand or supply side, the greater the likelihood that they are supplied and acquired in the same market.

Supply Side Substitution

73. Close substitute products on the supply side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

74. The Commission considers that supply side substitution is not relevant in this case. Forest and woodlot owners have no ability to alter a log's grade in the years before it is harvested. Along with predetermined environmental and silvicultural issues, an individual log's grade is mostly determined by the position on the tree from which it is cut. Logs from the lower parts of exotic trees tend to have a higher density and better structural properties than logs from the upper sections of such trees.

75. In Decision 602, Rayonier advised the Commission that "generally you wouldn't want to sell your S grade logs to export" and that "It's generally a higher specification log and you wouldn't get the (same) price on export".

76. The lower parts of a plantation tree may be pruned and produce knot free logs that are typically used for aesthetic purposes (although this is not common in Canterbury forests where the majority of trees are not pruned). The next section of the tree is an unpruned section that will produce sawlogs of varying grades according to physical dimensions and knot size. The highest and therefore youngest part of the tree produces low density pulp logs.

¹⁷ Section 3(1A) of the Act.

Demand Side Substitution

77. Close substitute products on the demand side are those between which a sufficient number of buyers would switch given an incentive to do so by a small change in their relative prices such that the relative price difference is disciplined.
78. Processors of unpruned sawlogs in Canterbury have specialised requirements regarding the properties of the logs. Sawmill managers interviewed by the Commission produce either only structural timber from S grade logs, or only industrial timber (and products fashioned from such timber) from L grade logs.
79. Sawmills which produce structural timber, require all their log supply to comprise S grade (small knot, no greater than 60mm diameter) unpruned sawlogs, as about 65% of the volume of such logs can be converted into structural timber.¹⁸ On the other hand, only about 30% of L-grade (large knot, no greater than 140mm) sawlogs can be converted into structural timber. While L-grade sawlogs are lower priced than S-grade sawlogs, a SSNIP of S-grade sawlogs would not be sufficient to induce sawmills producing structural timber to switch to L-grade sawlogs. This is because of higher amount of waste wood per log and because the additional processing costs (eg increased labour costs and less throughput) per unit of timber output. The Commission's interviews of the six mid Canterbury sawmill owners and managers revealed that in fact there is only marginal demand side substitution between L-grade and S-grade sawlogs (see footnote 18).
80. [] stated that it would not use L-grade "at any price" because it would be unable to produce timber of the lengths its customers demand. L-grade logs would have to be cut to less than optimal lengths to remove oversize knots. [] stated that because of the extra waste wood factor it also would not consider using L-grade logs in its sawmill.
81. SRS Ltd is the only substantial processor of L-grade logs in the region. SRS Ltd purchases its L-grade logs at much lower prices than the S-grade logs purchased by the structural sawmills (up to \$[] per tonne less on average prices of about \$[]/tonne). The only other outlet for L-grade logs in mid or north Canterbury is to export via Lyttelton. SRS Ltd has no requirement for S-grade logs as it does not produce structural timber and does not wish to pay the price premium required in order to obtain S-grade logs.
82. The Commission confirms its view that pulp logs are in a separate market. Pulp logs tend to come from the younger parts of a tree and are therefore less dense, smaller and not suitable for production of sawn timber, only woodchips.

Conclusion on Product Markets

83. The Commission concludes that the product markets relevant to the analysis of the present application are the supply of:
- structural grade unpruned sawlogs (S-grade market);
 - industrial grade unpruned sawlogs (L-grade market); and
 - pulp logs (pulp log market).

¹⁸ []. []. In addition, []

[] The Commission considers that [] is an outlier which does not affect the general conclusions it reaches on the relevant product market. Were it otherwise, one would expect that purchases of L-grade logs for traditional S-grade log usages would result in price pressure on S-grade logs, eroding the price differential down from the current \$[]/tonne.

Functional Markets

84. The proposed application involves aggregation of forest ownership and log production. The Commission concludes, for the purposes of the present application, that the relevant functional market is the production and supply of various grades of logs.

Geographic Markets

85. 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 in sufficient numbers should the prices of local sources of supply be raised by a SSNIP so as to discipline the price increase.

Matariki's view of the scope of the relevant geographic market

86. Matariki submitted that logs processed in Canterbury can be sourced from anywhere within a 189km radius of Rolleston, which would include the West Coast and extend to Kaikoura in the north, and to the Waitaki River in the south. This submission is based on Matariki's view of:

- previous Commission decisions on the geographic scope of log markets;
- chip and sawlog prices in Canterbury;
- the cost of transport by road or rail from the West Coast to Canterbury processors;
- the fact that West Coast produced industrial logs are currently exported through Lyttelton;
- the fact that in the past West Coast sawlogs were routinely transported to Canterbury processors, particularly when a back load was available; and
- the fact that Matariki currently transports logs from its Hamner Forest to Rolleston, a distance of approximately 150km which therefore would mean that all logs in the region can be economically transported a distance that is within 150km. To that Matariki submit must be added about another 20 – 25 kilometres to take account of the application of a SSNIP.

87. This is in contrast to Matariki's own statements in 2008 where it described Canterbury as being "geographically isolated" and that the "supply of external logs to the region is limited by high transportation costs".¹⁹ Matariki has subsequently dismissed this statement as being no longer relevant due to the higher log prices now current in comparison to 2008. However, log prices are variable and are currently rapidly coming off recent highs. The Commission considers that Matariki's own statement is important evidence pointing to the restricted geographic scope of the relevant log markets.

Are West Coast suppliers in the relevant geographic market?

88. Canterbury Sawmills advised the Commission that they are able to source logs from the West Coast at suitable prices, only in small quantities and only if a back load is available. FML informed the Commission that it sends logs produced in its West Coast woodlots to Canterbury only as a last resort if no other purchaser is available on the West Coast or in Nelson. As noted above SML informed the Commission that the cost of log transport from the West Coast to Canterbury is about [] per tonne (in comparison to the average cost of log transport in mid and north Canterbury of [] per tonne).²⁰

¹⁹ Matariki Information Memorandum for potential purchasers – 2008.

²⁰ Depending on whether the estimate of PF Olsen [] or SML [] is accepted.

89. Crown Forestry advised the Commission that in the near future there will be almost no logs available from its exotic forests in the West Coast for sale to Canterbury processors.²¹ Crown Forestry has contracted to sell up to [] tonnes of its log output to a new sawmill, recently commissioned at Stillwater by Southern Pine Products. This sawmill has been designed to process unpruned sawlogs of all grades, a first for the West Coast. Previously, substantial volumes of unpruned sawlogs were transported to Canterbury sawmills because there were few alternative purchasers on the West Coast.
90. The combination of access to a local sawmill and the high cost of transporting logs from the West Coast to Canterbury ([] per tonne on a backload basis) means that West Coast logs are unlikely to be sourced even in the event of a SSNIP to Canterbury sawmills. The Commission therefore concludes that the West Coast suppliers are not in the relevant geographic market.

Are South Canterbury suppliers in the relevant geographic market?

91. Matariki submitted that it currently transports logs from its Hanmer Forest to Rolleston, a distance of approximately 150km. According to Matariki this implies:
- that all logs in the region can be economically transported a distance that is within 150 kilometres;
 - the geographic scope of the relevant logs markets is that area within a radius of 150 kilometres from the nominal geographical centre of the mid Canterbury processors at Christchurch International Airport;
 - to that must be added about another 20 – 25 kilometres to take account of the application of a SSNIP; and
 - under this analysis the South Canterbury exotic forests would fall for consideration within the relevant geographic market.
92. The Commission does not consider that Matariki’s analysis accords with the factual situation that the Commission’s investigation has revealed.
93. The Commission considers that it should not accept the example of the transport of Hanmer logs to processors to include South Canterbury in the relevant market. Unlike the Hanmer situation, there are log sale options available to South Canterbury forest owners that are closer than 150 kilometres.²² The correct approach is for the Commission to evaluate whether South Canterbury forest owners would supply mid and north Canterbury sawmills in the event of a SSNIP in log prices in mid and north Canterbury.
94. SML informed the Commission that the cost of transporting logs from South Canterbury to the Christchurch area is about \$[] per tonne, \$[] more than the average mid and north Canterbury log transport cost and \$[] more than the transport cost they would incur to the port of Timaru for export. When South Canterbury suppliers are evaluating whether to supply mid and north Canterbury sawmills they will compare the export price they receive net of transport costs with the domestic price net of transport costs.
95. Frews stated that it does not transport any logs to Mid-North Canterbury processors/port from further south than Ashburton or further north than from Hanmer. Frews charges an average price of \$[] per kilometre per tonne for a 75 kilometre haul, which reduces

²¹ Crown Forestry owns the major “corporate” forests on the West Coast. Other West Coast exotic forests are of the woodlot variety.

²² Hanmer forest is geographically isolated with no port or significant processors nearby.

slightly if it transports logs over a greater distance due to the fixed cost of handling at either end of the trip being spread over a greater number of kilometres.

96. Sawmill owners and managers informed the Commission that no S-grade logs have been transported from South Canterbury to the mid Canterbury processor in the last five years, this during a period when log prices to mid Canterbury structural processors have risen from \$[] per tonne to \$[] per tonne.
97. Blakely does supply about [] tonnes of L-grade logs per year to SRS Ltd in Rolleston for \$[] per tonne including delivery, a price [] than the [] it could typically receive from export sales and also [] than the \$[] that Matariki charges. SRS Ltd is the southernmost of the mid Canterbury sawmills and Blakely supplies these logs from the northernmost of its forests (near to Geraldine) to reduce the transport distance. Blakely informed the Commission it []²³ Blakely also informed the Commission that it would require saw-log prices to increase by at least 15% before it would be economic for it to transport its structural logs to sawmills in Canterbury. Blakely cites a lack of local processors in South Canterbury as the reason why it sells logs to SRS Ltd.

Conclusion on Geographic Market

98. The Commission considers that for the purposes of assessing the competition implications of the proposed acquisition, the appropriate geographic market is that encompassing mid and north Canterbury (incorporating the Christchurch City and the Hurinui, Waimakariri, Selwyn and Ashburton Districts).

Temporal Dimension

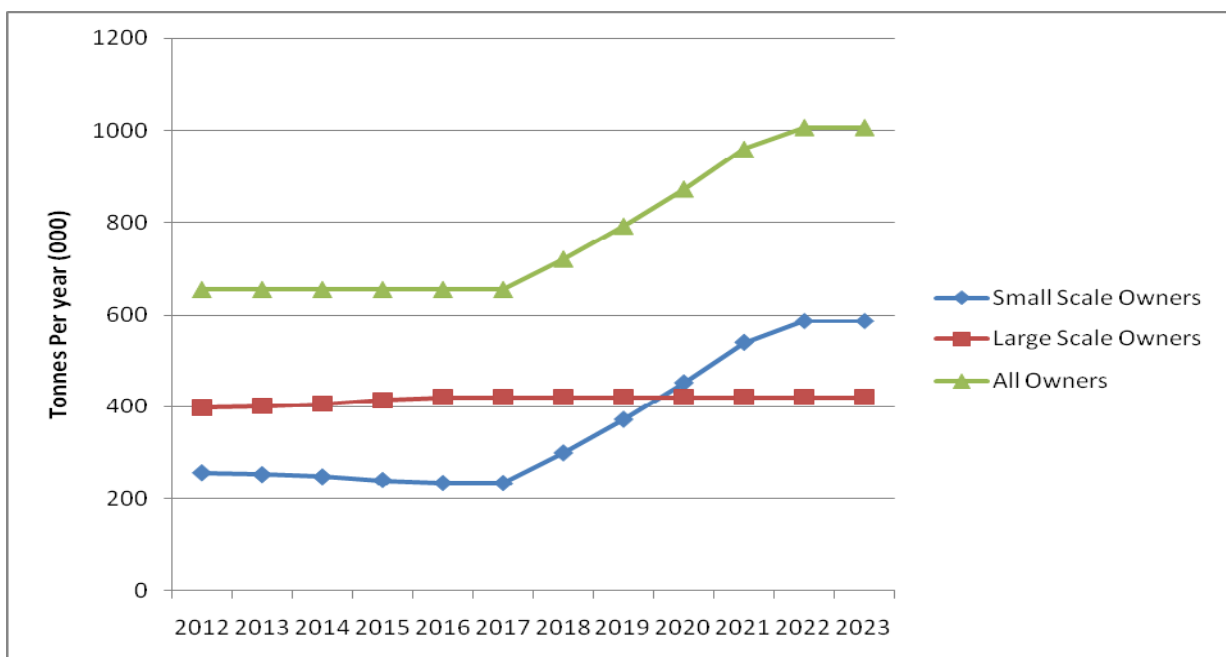
99. The Commission typically views markets as operating continuously over time. However temporal considerations may be important where depletable resources are involved, as is the case with forestry, where production depends substantially on the level of planting that occurred many years before the harvesting of the trees. For example radiata pine which accounts for 75% of Canterbury's plantation forests takes up to 28 years to reach the age where it is most economic to harvest in Canterbury. Therefore each firm's potential production will depend on the age structure of its forests, and its market share can vary over time.
100. A further factor unique to an analysis of log production in Canterbury is the requirement, under the Treaty settlement of the Ngai Tahu South Island claim, to return certain publicly owned forestry land to the Tribe. The Commission has been informed that Ngai Tahu does not intend to use all of the returned land for the purposes of forestry. This will have the effect of reducing the production of logs from Matariki's forests in the future. Matariki has informed the Commission that one reason for its proposed purchase of SPB is to allow it to maintain production levels at an even level of about [] tpa, in spite of the ceding of production forestry land to Ngai Tahu.
101. The Commission was informed that forest owners may be able to accelerate or defer log harvesting by some years. Acceleration of harvesting levels may be constrained by the loss in volume and strength when a younger than optimum tree is harvested. Deferral of

²³[]. During periods of high export prices it continues to supply local processors, rather than export markets. It has found over time that supplying local processors and receiving stable returns is a profit maximising strategy in comparison to supplying its entire production to volatile export markets.

harvesting can only be done for a few years due to the diameter of such logs becoming too large for the machinery in the mid Canterbury sawmills. Deferral of harvesting also results in loss of the time value of money.

102. The Applicant submitted that the relevant timeframes, based on previous decisions of the Commission should be 2012-2015, 2016 – 2019 and 2020 -2023. In Decisions 588 and 589, the Commission considered it appropriate to define distinct temporal dimensions within the relevant markets for 15 and 12 years respectively, divided into three segments.
103. There are a number of factors which affect wood flow forecasts including log prices and market demand which can not easily be predicted. For example if there was another strong windstorm that resulted in many trees being blown over (windthrow) such as occurred in Canterbury in 1975, there would be an immediate unanticipated surge in production. Plantation forests and woodlots on the Canterbury Plains are particularly vulnerable to windthrow due to the frequent strong North Westerly gales that occur. Increased log production arising from increased market demand for sawn timber (perhaps as part of the increased need for new commercial and domestic buildings in Christchurch as a result of earthquake damage) is also difficult to predict in respect of timing and volumes. The Commission has noted the information contained in Figure 1 which is an adjusted reproduction of figure 4.10 from the Ministry of Agriculture and Forestry's (MAF) 2007 study of Wood Availability Forecasts in Canterbury.²⁴

Figure 1: Mid-North Canterbury Radiata Pine Predicted Harvest 2012 - 2023



104. It is noteworthy that mid and north Canterbury production from large scale owners (that is the merged entity) is predicted by MAF to be essentially constant at about 400,000 tpa (tonnes per annum) for the foreseeable future. []

²⁴ Five scenarios were discussed in the MAF paper. The Commission considers that Scenario 4 is the best representation of what is likely to occur given availability of logging infrastructure and demand for logs both domestically and for export. Scenario 4 is based on the standard 30 year rotation of radiata forest crops. Given the Commission's conclusion that the scope of geographic market definition only includes mid and north Canterbury, the Commission has adjusted the Canterbury wide production in the MAF data by a factor of 0.75 to exclude production from South Canterbury. Matariki agrees with this factor.

105. Figure 1 also shows total predicted production of radiata pine in mid and north Canterbury. The difference between the total production and production from large scale owners is production from woodlots which is initially constant but rises beginning in 2018 to reach a steady increased level in about 2022.

Conclusion on the temporal dimension

106. The Commission considers that any competition effects arising from the acquisition can best be examined during the period 2012 to 2018. The relevant markets are likely to be most concentrated during that period. If the merged entity does not acquire market power during that period, it is unlikely to have market power thereafter, once woodlot production rises substantially.

Conclusion on the Relevant Markets

107. In this instance, the Commission has taken a conservative approach to market definition, confining its analysis to the narrowest market in which a substantial lessening of competition might occur on the basis that if it does not, competition concerns are unlikely to arise in wider markets.
108. The Commission, for the purposes of analysing this proposed acquisition, concludes that the relevant markets are:
- the production and supply of pulp logs in mid and north Canterbury for the period 2012-2018.
 - the production and supply of L-grade logs in mid and north Canterbury for the period 2012-2018; and
 - the production and supply of S-grade logs in mid and north Canterbury for the period 2012-2018.

COUNTERFACTUAL

109. Matariki submitted that the most likely counterfactual scenario would see SPB purchased by a vertically integrated overseas company that could have a low cost sawmill at its overseas production facility. According to Matariki, the alternative buyer would value log supply to its low cost facility more than selling to Canterbury processors. Therefore, according to Matariki, all log production from SPB would be exported, and the counterfactual would be less competitive than the status quo.
110. The Commission notes that the underbidder in the second tender round was an [], which does not own processing facilities.
111. Moreover, the Commission considers that, on the basis of its investigation of other potential alternative purchasers, they would have continued to, at a minimum, sell S-grade logs to domestic processors. Such logs usually generate more value in the domestic market than if exported. Accordingly, the Commission considers that it is likely that an alternative purchaser of SPB's forestry assets would have a business strategy to continue supply to local processors. As noted in [] profit maximising strategy is to sell []% of its log production within New Zealand.
112. The Overseas Investment Office informed the Commission that in 2010 another overseas based party made an application to buy SPB, however that application was withdrawn

before the OIO could consider the application and that the application was not made with any provisional conditions regarding what proportion of logs would be sold to local processors.

113. Therefore, the Commission considers that an alternative owner of SPB’s estate would adopt the same strategy a SBP, therefore the status quo is the most likely counterfactual.

COMPETITION ANALYSIS

Pulp log Market

114. The Applicant submitted that:

- it would continue to face competition in the pulp log market from production from woodlots in Canterbury managed by forestry consultants; and
- it has a “symbiotic”²⁵ relationship with Daiken, the only significant purchaser of pulp logs in Canterbury.

115. Table 3 shows the market shares in the pulp log market in the relevant region. These would remain essentially constant during the period 2012 -2018. Competition to the merged entity would continue to arise from the supply of pulp logs from woodlots.

Table 3: Predicted Market Shares for the Pulp Log Market 2012-18

	June 2010 – May 2011		2012-2018	
	Tpa (000)	%	Tpa (000)	%
Matariki	[]	[]	[]	[]
SPB	[]	[]	[]	[]
Merged entity	[]	[]	[]	[]
FML woodlots	[]	[]	[]	[]
PF Olsen woodlots	[]	[]	[]	[]
TTFL woodlots	[]	[]	[]	[]
Laurie woodlots	[]	[]	[]	[]
Other woodlots	[]	[]	[]	[]
Total	[]	100	[]	100

Source: market participants

116. Table 3 shows that the merged entity would have a market share of []% and the three-firm concentration ratio would increase from []% to []%. There would be relatively minor aggregation of market share.
117. The market share of the combined entity during the period 2012 – 2018 is expected be lower than its current level because of Matariki and SPB’s current temporary high harvest volumes (as discussed above in paragraphs 11 and 17).
118. PF Olsen submitted that pulp logs have low value and it is not economic to transport them for long distances. For example, PF Olsen advised that it is only feasible to transport pulp logs away from the Crown Forestry plantations it manages on the West Coast if a back load is available to Nelson. Otherwise, it leaves the pulp log component of its production to rot on forest floors.

²⁵ By use of this word Matariki submits that Daiken depends on Matariki to supply its pulp log inputs while at the same time Matariki depends on Daiken to purchase pulp logs as there is no other significant local purchaser of pulp logs. Without Daiken, Matariki would have no outlet for its pulp logs other than sale to export markets or to firewood merchants, thus garnering overall, lower returns.

119. Matariki informed the Commission that the situation is not so dire as that in Canterbury as it has the potential to export pulp logs through the Port of Lyttelton. However, during the June 2010 to May 2011 year, pulp log exports were only [] of total log exports from mid and north Canterbury. Matariki informed the Commission that at present, its Lyttelton wharf gate export price is about [] per tonne annual contract price for the supply of pulp logs to Daiken (although earlier in the year that differential was reversed).
120. Daiken informed the Commission that in addition to the [] tpa of pulp logs it sources per year, it obtains a further [] tpa of woodchips from local sawmills. [

].

121. Other than Daiken and export markets, the only other purchasers of pulp grade logs are firewood merchants. Daiken advised the Commission that large quantities of pulp logs are not exported from Lyttelton as they take away scarce wharf space for higher value logs.
122. The Commission considers that there would be a high degree of mutual dependence between Matariki and Daiken post acquisition. Daiken is a large reliable consumer of what is a low value product that is situated adjacent to a major Matariki forest (Ashley) and close to the other Matariki and SPB mid and north Canterbury forests. While at times pulp export prices would be higher than Daiken's annual contract price, Matariki advised that its long term profit maximising strategy is to supply locally to remove export volatility (and that strategy applies to its supply of all grades of logs).
123. Therefore, the Commission considers that Daiken has countervailing power against Matariki in the market for the supply pulp logs as Daiken has alternative sources for such logs (local woodlots and wood chips from sawmills), while Matariki has few alternative purchasers. Matariki would, on its own reasoning lose net revenue if it was required to export more of its pulp log production.
124. The Commission considers that Daiken's countervailing power will be a strong constraint on the merged entity post-acquisition.

Overall Conclusion on the Pulp Log Market

125. The Commission is satisfied that the proposed acquisition would not have the likely effect of substantially lessening competition in the pulp log market. This is because the combined entity would be constrained by a combination of:
- the supply of pulp logs supplied by woodlots in mid and north Canterbury;
 - Daiken's ability to use woodchips as an alternative source of raw material supply; and
 - the merged entity only has less profitable (in the long term) alternative purchasers for its pulp logs.

L-grade log market

126. The Applicant submitted that there is a single market for unpruned sawlogs which includes S-grade and L-grade logs. However, as explained in the market definition section the Commission considers that there are separate markets for S-grade and L-grade unpruned sawlogs and has analysed below the competition effects of the proposed acquisition in both those product markets.

127. Table 4 shows the market shares in the L-grade log market in the relevant region. These will remain essentially constant during the period 2012 -2018:

Table 4: Predicted Market Shares for the L-grade Log Market

	June 2010 – May 2011		2012-2018	
	Tpa (000)	%	Tpa (000)	%
Matariki	[]	[]	[]	[]
SPB	[]	[]	[]	[]
Merged entity	[]	[]	[]	[]
FML woodlots	[]	[]	[]	[]
PF Olsen woodlots	[]	[]	[]	[]
TTFL woodlots	[]	[]	[]	[]
Laurie woodlots	[]	[]	[]	[]
Other woodlots	[]	[]	[]	[]
Total	[]	100	[]	100

Source: market participants

128. Table 4 shows that the merged entity would have a market share of []% and the three-firm concentration ratio would increase from []% to []%. Again, there would be relatively minor aggregation of market share and the market share of the combined entity is expected be lower than its current level because of Matariki and SPB's current temporary high harvest volumes(as discussed above in paragraphs 11 and 17).
129. Post acquisition, Matariki would be the only corporate log supplier in mid and north Canterbury, constrained only by woodlots. Various industry sources informed the Commission that sawmills prefer the bulk of their log supply to come from corporate forestry suppliers. This is because they tend to be more reliable in terms of log quality, timeliness of delivery and harvest volumes.
130. SRS Ltd purchases about [] tpa, about []% of the industrial logs produced in mid and north Canterbury. The remainder of such logs are exported.²⁶ SRS Ltd had few concerns regarding the acquisition. It informed the Commission that it currently obtains [] of its log supply from Matariki and SPB. However, it has arranged its forward supply so that it will obtain []. SRS Ltd stated that it would be able to increase its supply from local woodlot owners, and if necessary would even consider owning woodlots if its diversity of log supply was at risk.
131. As stated above, industry sources²⁷ informed the Commission that export returns for logs are volatile while domestic prices are stable over time. SRS Ltd, as the only significant industrial log purchaser therefore would provide a hedge against this volatility.
132. The Commission considers that SRS Ltd, as the sole local purchaser/processor of L-grade logs has sufficient countervailing market power to constrain the merged entity as a result of:
- the large proportion of L-grade logs produced in the relevant local market that it would purchase; and
 - Matariki's stated profit maximising strategy of local rather than export supply.

²⁶ Except as stated above, for a small amount consumed by [] sawmill.

²⁷ Matariki, SRS Ltd, Blakely and PF Olsen. Indeed, Blakely informed the Commission that it is willing to incur the additional transport costs and lower net returns (in comparison to exporting or supply to South Canterbury/North Otago processors) to sell [] of its South Canterbury logs to SRS Ltd to achieve [].

133. In addition, the Commission also notes that SRS Ltd has a multiplicity of other potential log suppliers including (uniquely) Blakely, local woodlot owners and potentially its own woodlots.

Conclusion on L-Grade market

134. The Commission is satisfied that the proposed acquisition will not have the likely effect of substantially lessening competition in the L-grade log market. This is because the combined entity would be constrained by a combination of:

- SRS Ltd's ability to source alternative supply from woodlots ; and
- SRS Ltd's countervailing market power.

S-grade Log Market

135. As noted, the Applicant's position is that there is there is a single wide product market for unpruned sawlogs. However, Matariki also submitted that if the Commission does not accept that position and prefers a narrower S-grade product market (which it does), there is unlikely to be a substantial lessening of competition in that market because:

- a significant proportion of export A-grade logs meet the S-grade log standard and would be diverted from export by other suppliers in the event of a price rise post-acquisition;
- the combined market share of Matariki and SPB is currently at a temporary high level because Matariki has increased its harvesting rate from its Eyrewell and Balmoral forests prior to its early hand over to Ngai Tahu. Additionally SPB has also increased its harvesting rate to generate maximum returns for its owners prior to its sale. Matariki states that, as a result, its market share post-acquisition would decline rapidly from its temporary present level; and
- the merged entity's market share will further decline sharply in 2018 due to the increased production from woodlots following the high levels of planting of woodlots in the early 1990s.

136. Table 5 shows the market shares in the S-grade log market in the relevant region. These will remain essentially constant during the period 2012 -2018:

Table 5: Predicted Market Shares for the S-grade Log Market

	June 2010 – May 2011		2012-2018	
	Tpa (000)	%	Tpa (000)	%
Matariki	[]	[]	[]	[]
SPB	[]	[]	[]	[]
Merged entity	[]	[]	[]	[]
FML woodlots	[]	[]	[]	[]
PF Olsen woodlots	[]	[]	[]	[]
TTFL woodlots	[]	[]	[]	[]
Laurie woodlots	[]	[]	[]	[]
Other woodlots	[]	[]	[]	[]
Total	[]	100	[]	100

Source: market participants

137. Table 5 shows that the merged entity would have a market share of []% and the three-firm concentration ratio would increase from []% to []%. Again, there would be relatively minor aggregation of market share and the market share of the combined entity is expected

be lower than its current level because of Matariki and SPB's current temporary high harvest volumes(as discussed above in paragraphs 11 and 17).

138. Post acquisition, Matariki would be the only corporate log supplier in mid and north Canterbury, constrained only by production of S-grade logs from woodlots. However, certain mid Canterbury processors interviewed by the Commission submitted that they preferred a high proportion of their log input to be supplied by Matariki and SPB, as *corporate* forestry suppliers. In their opinion, corporate log supply was more reliable in terms of log quality and timeliness of delivery, particularly under winter ground conditions.
139. Other evidence obtained by the Commission contradicted those views. For example, SML as a very knowledgeable industry participant and long term transporter of logs in the region, stated that in its experience harvesting and production of logs in winter is not affected by soft ground conditions to any great extent. Production from weather dependant and non-weather dependant logging sites is managed by the forest owners and forest consultants such that there is minimal disruption to log flows to local sawmills.
140. Moreover, FML, currently the third largest log producer in the relevant market, stated that its winter harvest levels are much the same as those in summer. During winter, FML concentrates its production in forest blocks that have better access and ground conditions.
141. In addition the evidence suggests that Woodlots in Canterbury produce much the same proportion of S-grade logs as do Matariki and SPB. Their S-grade production is currently [] and [] respectively of their total log production. In comparison, FML's S-grade output from its woodlots is a very similar [] of it total production.
142. The Commission therefore considers that, while there is conflicting evidence, on balance the quality and year round availability of S-grade logs from mid and north Canterbury woodlots is likely to be comparable to corporately owned forests. Accordingly, the Commission considers that production from local woodlots would be sufficient in quality, reliability and, given the post acquisition market shares, volume, to constrain the merged entity.
143. Mid and north Canterbury processors are required to source a relatively high proportion of their logs from woodlots in comparison to processors in other regions of New Zealand. Without supply from woodlots there would be insufficient log supply to support the entirety of the local sawmilling industry. This is the reason for the relatively minor aggregation of market share arising from the proposed acquisition. In the Commission's view, woodlots would be a major component of log supply in the relevant region in both the counterfactual and the factual.
144. The Commission considers that S-grade log processors in mid and north Canterbury are unlikely to have a high degree of countervailing power as they are all relatively small scale and there is a sufficient number of them to allow the merged entity to reapportion sales volumes away from price increase resisters (unlike the situation with Daiken in the pulp log market and SRS Ltd in the L-grade log market).
145. Mid Canterbury sawmillers are small to medium volume producers of structural timber. On the other hand, the largest suppliers of structural timber in Canterbury are Carter Holt Harvey (CHH) and Red Stag, who supply timber from much larger saw mills in Nelson, Northland and the Central North Island. These high volume timber suppliers have economies of scale that allow them to supply timber in Canterbury at very competitive prices. There is currently a price war existing between CHH and Red Stag. It appears to the Commission that structural timber prices in Canterbury are likely to be capped by competition from out of region timber suppliers. This then would limit the potential for

local structural timber sawmillers to raise prices in the event of any log price increase applied by the merged entity. Matariki has stated its profit maximising strategy would be to maintain structural log supply to local processors. That strategy would be likely to fail if local processors were driven to the wall by a Matariki-applied squeeze of local sawmillers, between higher log prices and structural timber prices, capped by out-of-region suppliers. Processors would be unlikely to remain as purchasers of S-grade logs in circumstances where they faced both increased raw material input costs (logs) and competition in the downstream market for the supply of structural timber (including from large out of region suppliers). Therefore, in the Commission's view, the merged entity would, to some extent, be constrained in its ability to increase prices post-acquisition by competition in timber markets.

Conclusion on the S-grade Log Market

146. The Commission is satisfied that the proposed acquisition would not have the likely effect of substantially lessening competition in the S-grade log market. This is because the combined entity would be constrained from increasing S-grade log prices by a combination of:
- the supply of S-grade logs from woodlots in mid and north Canterbury; and
 - Matariki's incentive to maintain the local sawmilling industry in the face of a limited ability of sawmillers to raise the sale price of their timber production.

COORDINATED MARKET POWER

147. There are about 130 woodlot owners in the relevant geographic market, that have forestry holdings larger than 40 hectares and which are managed by four different forestry consultants/managers.
148. The seller concentration in the relevant markets is relatively low with the merged entity supplying just under half the market volume and the balance of the market shared between woodlot owners production aggregated by four forestry consultants/managers. In the Commission's view low seller concentration tends to reduce the potential for coordination.
149. In addition, sawmills have the ability to, and do, bypass the forestry consultant/manger concerned to contract directly with woodlot owners to arrange log production from the woodlot.
150. While Matariki and FML do have a relationship, that is merely a non-exclusive contract to supply export logs to Matariki's shareholder, Rayonier. There is no profit sharing or Joint Venture arrangement between them. Under the contract, FML is able to utilise another exporter such as Tenco if it prefers. FML has recently done this at Napier despite it having a supply contract with Rayonier.
151. The Commission considers that these factors indicate that there is no increased likelihood of coordinated market power.

OVERALL CONCLUSION

152. The Commission has considered the probable nature of competition that would exist subsequent to the proposed acquisition in the mid and north Canterbury markets for pulp logs, L-grade logs and S-grade logs.
153. The Commission considers that in the markets for pulp logs and L-grade logs, competition from forestry managers/consultants along with some constraint provided by the countervailing power of log processors is likely to be sufficient to constrain the combined

entity. In the market for S-grade logs, competition from forestry managers/consultants along with some constraint provided by the level of competition in the Canterbury region for finished timber produced from S-grade logs is likely to be sufficient to constrain the combined entity. Accordingly, the Commission is satisfied the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

154. Having considered the competition effects of the proposed acquisition, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the relevant markets.

DETERMINATION ON NOTICE OF CLEARANCE

155. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Matariki Forests to acquire all of the forestry assets of Selwyn Plantation Board Limited.

Dated 28 September 2011

Dr Mark Berry
Chair