Wool scour merger heads to court after regulator tick

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The Commerce Commission's decision to allow the merger of New Zealand's remaining two wool scourers was extremely finely balanced.

Last week, it approved the merger of Cavalier Wool Holdings and New Zealand Wool Services International's wool scouring business.

However, the merger has been temporarily stayed by the High Court and Cavalier's arch-rival in carpet manufacturing, Godfrey Hirst, is appealing the decision.

As the commission said in its press release: "this acquisition is likely to substantially lessen competition.

"Cavalier will essentially have a monopoly on the supply of wool scouring services and the supply of wool grease, and will be able to raise its prices when the merger is completed," it said.

"However, our analysis has shown that there are public benefits to New Zealand from this acquisition proceeding," it said.

"We expect that the rationalisation of the wool scouring industry is likely to lead to lower administration and production costs, the freeing up of industrial sites, and lower ongoing capital expenditure requirements in the future."

The commission also took into account that the declining wool clip is causing a loss of scale and the threat of greasy exports is increasing.

It seems a safe assumption that the commission always expected the decision would end up in court.

In 2011, the corporate regulator approved a previous proposed merger between the Cavalier wool business and NZWSI's wool scouring business.

Godfrey Hirst challenged that decision in the High Court and lost.

In this latest case, the commission's process in arriving at the final decision was protracted, taking more than a year - the application was lodged in October last year.

The commission also took the unusual steps of publishing a second draft decision and conducting a further hearing of the parties' views behind closed doors, as well as the first public hearing.

In assessing the net impact of the merger over the first five years, the commission ended up with a net benefit range of just $0.81 million to $23.42 million.

Over a 10 year period, the low end of its assessment was a net detriment of $1.37 million ranging up to a net benefit of $34.27 million.

That was a marked change from its second draft determination when the low end five-year net benefit was put at $4.51 million and the 10-year low end was a net $2.56 million benefit.

The key change was that the commission accepted Godfrey Hirst's arguments that Cavalier's plant at Clive was likely to close anyway, merger or no.

"We consider that, absent the merger, there is a real chance that Cavalier would close or sell the Clive site in the near future," the commission said in its final determination.

“On this basis, we do not consider that we can attribute any benefit to the sale of Clive, as in this scenario, any post-acquisition sale would not be considered a merger-specific benefit.”

After the second draft determination was published, Godfrey Hirst’s lawyer, Grant David of Chapman Tripp, said the regulator had moved the goal posts of how it defines the relevant market so it can approve the merger. If it had stuck to its previous definition, it would have had to conclude that the loss of competition outweighed the estimated benefits of the merger, he said.

DLA Piper partner Mark Williamson, who specialises in competition law but who wasn’t involved in the wool scouring case says that “this is clearly a matter which is finely -balanced.”

The commission would have had the High Court’s reasoning from the 2011 in mind and appear to have adopted a rigorous approach and were careful to give all affected parties an opportunity to be heard, he says.

“It’s pretty unusual to have a second draft determination following the first draft in a merger or authorisation context. I haven’t seen that before,” Mr Williamson says.

He thinks the commission is to be commended for taking that extra step, though “because ultimately it should lead to more accurate decision making,” he says.

“What we’re talking about here is a merger to a monopoly. It isn’t something which should be authorised lightly.”

Godfrey Hirst does have an arguable case that the commission did move the goal posts between its first and second determination but it will be for the court to decide on that issue, Mr Williamson says.

But ultimately the decision wasn’t just made on quantitative factors.

“There’s never going to be an objective right answer. What everyone’s looking to do is work out the best answer within the time frame and given the range of different views,” he says.

“There are a lot of qualitative aspects as well – there’s always going to be room for argument about these things.”