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COMMERCE COMMISSION

Decision No. 466

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

FIRTH INDUSTRIES

and

GILL CONSTRUCTION CO LIMITED

The Commission:	MJ Belgrave PR Rebstock PJM Taylor
Summary of Application:	The acquisition by Firth Industries, ("Firth") a wholly owned subsidiary of Fletcher Concrete and Infrastructure Limited., to acquire the assets comprising the ready mixed concrete business of Gill Construction Co Limited ("Gill") in Blenheim.
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:	26 July 2002

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THE PROPOSAL

1. On 9 July 2002 the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 ("the Act") from Firth Industries ("Firth"), for it (or interconnected body corporate) to acquire the assets comprising the ready mixed concrete business of Gill Construction Co Limited ("Gill") in Blenheim.

2. Firth seeks clearance from the Commission on the basis that the transaction will not have the effect of substantially lessening competition in any market in New Zealand.

THE PROCEDURES

3. 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 notice agree to a longer period. Extensions of time were sought by the Commission and agreed to by the Applicant. Accordingly, a decision on the application was required by 26 July 2002.

4. In its application, Firth sought confidentiality for specific aspects of the application. A confidentiality order was made in respect of the information for a period of 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

5. The Commission's determination is based on an investigation conducted by staff.

6. The Commission's approach is based on principles set out in the Commission's *Practice Note 4*.[1]

THE PARTIES

Firth Industries

7. Firth, a division of Fletcher Building Limited, produces and distributes ready-mixed concrete from 52 fixed sites throughout New Zealand. It is estimated that its national market share is around [ ]%. On 15 August 2000 Firth was amalgamated with The Golden Bay Cement Company ("Golden Bay"), which is another firm owned by Fletcher. Golden Bay is one of only two manufacturers and suppliers of cement in New Zealand, the other being Milburn New Zealand Limited ("Milburn").

8. Firth has a plant in Blenheim. From this plant it services Blenheim, Picton and the Marlborough Sounds, Havelock, west to the Rai Valley and to St Arnaud, and south to Seddon and Kaikoura. Firth has another plant in Nelson that supplies areas west of the Rai Valley.

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[1] Commerce Commission, *Practice note 4: The Commission's Approach to Adjudicating on Business Acquisitions Under the Changed Threshold in section 47 – A Test of Substantially Lessening Competition*, May 2001.

Gill Construction Co Ltd

9. Gill Concrete started operations in Blenheim in 1992. From its Blenheim concrete plant it services the Marlborough region. Gill's concrete plant was an addition to its general contracting business. Its services include roading, drainage, and earthworks. It is also a supplier of gravel, shingle, long-haul stock carriers and general carriers.

OTHER RELEVANT PARTIES

Allied Concrete

10. Allied Concrete ("Allied") is owned by H W Richardson Group, a privately owned South Island company. Allied produces and distributes ready-mixed concrete in the South Island and in Auckland. In 1989 Allied Concrete entered into a joint venture with Milburn cement to facilitate its expansion into the North Island. This joint venture was called Allied Milburn Limited ("Allied Milburn"). Allied and its associated companies operate from around 40 sites nationwide.

Graeme Smith

11. Graeme Smith is an independent operator producing concrete mussel floats and boat moorings in Havelock.

ACL Ashburton

12. A recent entrant into the Ashburton ready mix concrete market.

Porirua Ready Mix

13. A recent entrant into the Wellington ready mix concrete market.

Supacrete

14. A recent entrant into the Tauranga ready mix concrete market.

Crafar & Couch Construction

15. A Blenheim general contractor engaged in both domestic and commercial construction jobs.

Thompson & Devanny Construction

16. A Blenheim general contractor engaged in both domestic and commercial construction jobs.

T.H. Barnes

17. T.H. Barnes is a general contractor for both domestic and commercial jobs operating in the Marlborough region.

Haack Construction

18. Haack Construction is a general contractor operating in the Marlborough region.

Gravel Supplies

19. A Blenheim company that provides gravel and aggregate in the Marlborough region.

Fulton Hogan

20. A national company that provides gravel and aggregate in the Marlborough region.

Works Infrastructure

21. Works Infrastructure (Works) is a concrete company with a number of operating sites in the South Island. Works operates a small batch plant in Kaikoura it uses to supply small jobs outside its Christchurch area of operation. Works uses Allied to supply concrete in the Marlborough region.

New Zealand Ready Mix Concrete Association

22. The NZRMCA has self-imposed standards for ready-mixed concrete. Members of NZRMCA have their processes regularly checked by engineers to ensure that their concrete meets these standards. Gaining NZRMCA certification is important for concrete firms wanting to provide concrete for large commercial projects.

INDUSTRY BACKGROUND

23. Ready-mixed concrete is a building product used for both commercial and residential purposes. The combining of cement, water, sand, and coarse aggregates (particles of gravel or crushed stone) occurs in the process of concrete mixing and is best described in terms of a simple three-part system:

    - Cement + Water = Cement Paste

    - Cement paste + Sand = Mortar

    - Coarse aggregates + Mortar = Concrete.

24. The cement paste component functions to coat and "lubricate" the individual grains of sand, thereby imparting "workability" to the mortar phase. In turn, the mortar serves to lubricate the coarse aggregate particles and so give workability to the fresh concrete. Contrary to popular belief, concrete does not set and harden through a physical drying-out process. Setting and hardening is due to a series of chemical reactions between the cement and water present in the mix.

25. Ready-mixed concrete is produced by the cubic metre in a batching plant, where the raw materials aggregate, cement, water and additives (if any), are measured and mixed. In the dry-mix process, the ingredients are added in sequence to the rotating drum of the delivery truck, where they are then mixed. In the central-mix process, the ingredients are

mixed before being loaded into the truck. The ready-mixed concrete is then delivered to the site by truck, where it is placed and allowed to cure.

26. Ready-mixed concrete is a perishable product with a maximum life span of about 60-90 minutes from the time of mixing to placement. This can be extended with the use of additives, but these add to the cost. The strength of concrete is measured in MegaPascals or MPa, and is primarily determined by the proportion of cement per cubic metre. Concrete plants may produce concrete from strengths ranging from 10 MPa to 70 MPa, and even higher, but the bulk of sales appear to be made in the 17.5 Mpa and 20 MPa grades.[2] "Household grade" concrete, used by homeowners and builders in the foundations and flooring of houses, paths and driveways, is 17.5 MPa.

27. Apart from ready-mixed concretes of varying strengths, plants also produce concretes with a range of other properties, such as waterproofing, lightness, fast setting, plasticity (when wet) and size of aggregate used. Taking into account these various characteristics, a plant may produce well over a hundred product varieties. Often companies have their own "secret" mixes, which may vary depending upon the types of sands and aggregates available to them.

28. Ready-mixed concrete is priced by the cubic metre, delivery normally included, and the price varies according to the strength, additives used, and other characteristics of the mix required. However, it seems to be the accepted industry practice to use the price of one cubic metre of 17.5 MPa concrete, delivered, and excluding GST, as the benchmark for describing pricing levels. The price of 20 MPa concrete is usually about $5 or $6 more per cubic metre than 17.5 MPa concrete, reflecting the extra cost of the slightly greater proportion of cement in the mix. The pricing for other higher grades of concrete usually follows on from the 17.5 and 20 MPa grades in pre-set, incremental steps.

29. Prices vary widely throughout the country depending upon various factors, including the competitive pressures operating in each discrete market.

MARKET DEFINITION

30. The Act defines a **market** as:

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

31. For the purpose of competition analysis, a 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, could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the '*ssnip* test'). For the purpose of determining relevant markets, the Commission will generally consider a *ssnip* to involve a five percent increase in price for a period of one year.

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[2] For example, an analysis of 1683 Allied Milburn invoices for New Plymouth covering a four month period in 1999 shows 28% of invoices were 17.5 MPa concrete, and 39% were 20 MPa concrete, together accounting for 67% of all concrete sold over that period. Another sample of Firth Hastings invoices showed a total of 70% of all invoices were made up of 17.5 and 20 MPa concrete.

32. It is substitutability at competitive market prices which is relevant in defining markets. Where the Commission considers that prices in a given market are significantly different from competitive levels, it may be necessary for it to assess the effect of a *ssnip* imposed upon competitive price levels, rather than upon actual prices, in order to detect relevant substitutes.

33. The Commission will seek to define relevant markets in terms of four characteristics or dimensions:

- the goods or services supplied and purchased (the product dimension);
- the level in the production or distribution chain (the functional level);
- the geographic area from which the goods or services are obtained, or within which the goods or services are supplied (the geographic extent); and
- the temporal dimension of the market, if relevant (the timeframe).

34. The Commission will seek to define relevant markets in a way that best assists the analysis of the competitive impact of the acquisition under consideration. A relevant market will ultimately be determined, in the words of the Act, as a matter of fact and commercial common sense.

35. Where markets are difficult to define precisely, the Commission will initially take a conservative approach. If the proposed acquisition can be cleared on the basis of a narrow market definition, it would also be cleared using a broader one. If the Commission is unable to clear the proposed acquisition on the basis of the narrower market, it will be necessary to review the arguments and evidence in relation to broader markets.

Product Dimension

36. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market boundaries. Broadly speaking, a market includes products that are close substitutes in buyers' eyes on the demand-side, and suppliers who produce, or are able easily to substitute to produce, those product on the supply-side.

37. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[3] The Commission considers this to be a period of one year, which is the period customarily used internationally in applying the 'ssnip' test (see below) to determine market boundaries. The Commission will take into account recent, and likely future, changes in products, relative prices and production technology in the process of market definition.

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[3] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 351 Smellie J and the Court of Appeal on appeal approvingly quoted an earlier decision of the Commerce Commission in *Edmonds Food Ind Ltd v W F Tucker & Co Ltd* (Decision 21, June 1984) where the Commission had ruled: "A market has been defined as a field of actual or potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive". See also *News Limited v Australian Rugby Football League Limited &Ors* (1996) ATPR at 41,687, where Burchett J stated: "Long term prospects that can be more or less clearly foreseen are, to that extent, a present reality, from the point of view of identifying the constraints upon commercial action. This fact emphasises the importance of the principle . . . that substitution possibilities in the longer run may be very significant for market delineation." Also *Re Tooth & Co Ltd v Tooheys Ltd* (1979) 39 FLR 1 emphasises longer run substitution possibilities.

Demand-side substitution

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

39. Initially, markets are defined for each product supplied by two or more of the parties to an acquisition. Unequivocal substitutes are combined. For each initial market so defined, the Commission will examine whether the imposition of a ssnip would be likely to be profitable for the hypothetical monopolist. If it were, then all of the relevant substitutes must be incorporated in the market. If not, then the next most likely substitute good or service will be added to the initial market definition and the test repeated. This process continues until a combination of products is found which defines the product dimension of a relevant market, namely, the smallest combination of goods or services for which a ssnip would be profitable.

40. On the demand-side, the technical viability of one good or service as a substitute for another must be assessed. However, even where another product may technically be suitable as an alternative for the product in question, its price may be so much higher that it may be a poor substitute in an economic sense, at least for the great majority of buyers. In judging economic substitutability between products, the Commission will have regard to relative prices, quality and performance when assessing whether they are, in fact, close substitutes in the eyes of buyers.

Supply-side substitution

41. 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 in their relative prices.

Undifferentiated/Differentiated Products

42. In some instances, market definitional problems arise because of the differentiated nature of the goods or services involved in a business acquisition, caused by differing technical specifications, branding, packaging, warranties, distribution channels and other factors.

43. Where a significant group of buyers within a relevant market is likely to be subject to price discrimination, the Commission will consider defining additional relevant markets based on particular uses for a good or service, particular groups of buyers, or buyers in particular geographic areas. In other cases, the primary focus may switch to the extent to which a business acquisition eliminates competition between the products brought together by the acquisition.

Ready-mixed Concrete

44. About 70% of cement produced in New Zealand is used in ready-mix concrete production. It is predominantly in this form that cement emerges in its final product form, rather than as cement itself, which may be regarded as an intermediate product.

Hence, characteristics of the cement market are relevant to the consideration of ready-mixed concrete. These characteristics, in summary form[4], are:

- The cement market is served by a duopoly
- Cement prices are above competitive levels
- Demand for cement is likely to be very price inelastic

45. Since the price of ready-mixed concrete is likely to be inflated by the use of relatively high-priced domestic cement, the application of the ssnip test is likely to be problematic.

46. It is probably correct to say that the bulk of ready-mixed concrete is purchased by small and medium-sized users for laying floors in houses, industrial buildings and footpaths (but not for roads in this country). There are some large projects involving office buildings and various kinds of infrastructure (e.g., bridges, tunnels, dams, cold stores, etc.) which use large quantities of concrete. In New Zealand, there appear to be few close demand-side substitutes for concrete. While in many countries, concrete is used for roading and demand-side substitution would be possible, this does not apply to New Zealand where generally bitumen is used on roads. However, other products can be substituted for concrete in the building/construction sector, such as wooden flooring in houses.

47. Much of the concrete work in the Blenheim region is for new or expanding wineries. These operations typically require one or more very thick concrete slabs to bear the substantial weight of wine vats. There was no suggestion by interviewees that there was any substitute to concrete for such a use.

48. There are no substitutes on the supply-side, since ready-mixed concrete plants are highly specialised, apart from hand mixing on a very small scale by home owners and the like. At the other extreme, only the larger ready-mixed concrete suppliers are usually able to compete for the large project work, which may involve hundreds or even thousands of cubic metres of concrete. Virtually all plants are graded, and therefore able to supply a full range of concrete specifications and strengths.

49. The Commission therefore concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is the supply of ready mixed concrete.

Geographic Extent

50. The Commission will seek to define the geographical extent of a market to include all of the relevant, spatially dispersed, sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a ssnip is applied. Additional geographic regions are added until the smallest area is determined within which the hypothetical monopolist could profitably impose a ssnip.

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[4] For a fuller discussion of the cement market the reader is referred to *Commerce Commission Decision No. 416*.

51. Generally, the higher the value of the product to be purchased, in absolute terms or relative to total buyer expenditure as appropriate, the more likely are buyers to travel and shop around for the best buy, and the wider the geographic extent of the market is likely to be.

52. Where transport costs are high relative to the final value of a product, a narrower geographic market is more likely to be appropriate. Where product perishability and other similar practical considerations limit the distance that a product may be transported, this may limit the geographic extent of the market. The timeliness of delivery from alternative geographic sources is similarly relevant.

53. Although buyers and sellers of a particular good or service may interact in markets that are apparently local or regional in extent, those markets may themselves overlap and interrelate so as to form a market covering a larger geographical area. In these situations, the larger market is likely to be the appropriate one for analysing the competitive effects of a business acquisition.

54. The Commerce Act defines a market to be a "market in New Zealand". However, in many markets New Zealand buyers purchase products from both domestic and from overseas suppliers. Where imported products are close substitutes for domestic products, the overseas suppliers will be part of the relevant market. In such circumstances the Commission, in order to comply with the wording of the Act, is likely to define a national market and then, as discussed later in the competition analysis, to consider the extent to which overseas suppliers exercise a competitive constraint on the participants in the domestic market.

55. The Applicant has submitted a geographic definition of the market that includes the Blenheim region, Picton, Marlborough Sounds, Havelock, West to the Rai Valley and St. Arnaud and South to Seddon and Ward.

56. The Commission found in Decision 416 that geographic markets for ready-mixed concrete were relatively limited. The Commission recognised that ready-mixed concrete is a very perishable product, and its bulk renders the trucking costs quite high in relation to its value. It therefore cannot be practicably or economically transported far from the site of the batching plant. The Commission also noted that the opportunity cost of trucks rose steeply as the job's distance from the batching plant rose.[5] For these reasons the Commission considered the geographic markets were likely to be local in extent. The Commission estimated a maximum distance of around 40km for ordinary concrete and 60km for retarded concrete.[6] In cities, where traffic is likely to be more restrictive, the maximum distance reduces to around 20-25km.

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[5] The full example given in Decision 416 is as follows: if the job is at a distance of (say) 60 kilometres, this will take one of its concrete trucks one hour to travel, half an hour to discharge its load, another hour to go back to the plant, and a further half an hour to reload, making a total 3 hour turnaround for each truck. If the client wants six loads of concrete, one every half hour, a firm would need to have six trucks available to service this job, and the whole fleet would be tied up for a good part of the day, limiting its ability to service its local market. It can be seen that even an out of town job requiring one or two pours could tie up one or two concrete trucks and drivers for at least three hours.

[6] Concrete suppliers can extend the life of concrete by adding certain chemicals. These chemicals are known as "retarders".

57. In the present case, both parties to the acquisition operate out of Blenheim. As noted above, Firth services Blenheim, Picton and the Marlborough Sounds, Havelock, west to the Rai Valley and to St Arnaud, and south to Seddon and Kaikoura. Similarly, Gill has advised that it provides service throughout the Marlborough region. It does not service Kaikoura.

58. Works Infrastructure ("Works") operates a ready-mixed concrete plant in Kaikoura. Works has advised that it does not supply into the Blenheim region, as the distance is too great. The distance from Kaikoura to Blenheim is around 130km, which would put it well beyond the maximum distance estimated by Commission staff previously. Kaikoura will therefore not be included in the relevant geographic market for the purposes of the competition analysis.

59. The relevant geographic market is likely to cover Blenheim and surrounding areas including west to Rai Valley, southern areas down the coast (although not as far as Kaikoura) and Southwestern areas toward St Arnaud. For simplicity, this area will be referred to as "the Marlborough region".

Functional Level

60. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may affect one horizontal level, but not others.[7] Alternatively, some acquisitions, such as those involving businesses at different vertical levels, may raise issues related to vertical integration. Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

61. A feature of the concrete industry, which has developed only in the last 13 years, is the strong vertical integration of cement producers with concrete suppliers. For example, Golden Bay Cement sells about [ ] of its cement to Firth, which is by far its biggest customer. There is a similarly strong supply link between Milburn cement and Allied concrete suppliers (although Allied buys Golden Bay cement in Auckland). Prior to the mid-1980s there was no such vertical integration.

62. Independent ready-mixed concrete companies, such as Gill, have always had to purchase their cement requirements from either Golden Bay or Milburn in the course of competing with those two companies' downstream affiliates. The advent of imported cement in 1998 and 1999 resulted in a number of ready-mixed concrete companies and other cement users purchasing this cement. However, the quantities being imported have remained small and have reduced significantly since the end of 1999.

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[7] *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473, 502 The High Court (Greig J, Shaw WJ, Prof M Brunt) noted: "If we ask what functional divisions are appropriate in any market definition exercise, the answer, …, must be whatever will best expose the play of market forces, actual and potential, upon buyers and sellers. Wherever successive stages of production and distribution can be co-ordinated by market transactions, there is no difficulty: there will be a series of markets linking actual and potential buyers and sellers at each stage. And again, where pronounced efficiencies of vertical integration dictate that successive stages of production and distribution must be co-ordinated by internal managerial processes, there can be no market."

63. The functional level for the proposed acquisition is the manufacture and supply of ready mix concrete.

The Timeframe

64. Generally, the Commission will view markets as functioning continuously over time. However, where a market is characterised by, for example, infrequent transactions, the Commission may seek to define a separate time dimension as part of its market definition process. Time considerations are also important where there are long-term contracts, and where there are depletable resources.

65. Timeframe is not relevant to the market definition analysis.

Conclusion on Market Definition

66. The Commission concludes that the relevant market is:

- The market for the manufacture and supply of ready-mixed concrete in the Marlborough region.

COMPETITION ANALYSIS

Substantially Lessening Competition

67. Section 47 of the Act prohibits particular business acquisitions. It provides that:

> A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

68. Section 2(1A) provides that substantial means "real or of substance". Substantial is taken as meaning something more than insubstantial or nominal. It is a question of degree.[8] What is required is a real lessening of competition that is not minimal. The lessening needs to be of such size, character and importance to make it worthy of consideration.[9]

69. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[10]

70. While the Act defines the words "substantial" and "lessening" individually it is desirable to consider the phrase as a whole. For each relevant market, the Commission will assess:

- the probable nature and extent of competition that would exist in a significant section of the market, but for the acquisition (the counterfactual);

- the nature and extent of the contemplated lessening; and

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[8] *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406, 434; *Mobil Oil Corporation v The Queen in Right of NZ* 4/5/89, International Centre for Settlement of Investment Disputes, Washington DC, International Arbitral Tribunal ARB/87/2 (paras 8.2, 19, 20).
[9] *Dandy Power Equipment Ltd v Mercury Marina Pty Ltd* (1982) ATPR 40-315, 43-888; *South Yorkshire Transport Ltd v Monopolies & Mergers Commission* [ ] 1 All ER 289.
[10] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

- whether the contemplated lessening is substantial.[11]

71. In interpreting the phrase "substantially lessening competition", the Commission will take into account the explanatory memorandum to the Commerce Amendment Bill (No 2). The memorandum notes that:

> Two of the 3 key prohibitions are strengthened to bring New Zealand into line with Australian competition law, which will facilitate a more economic approach to defining anti-competitive behaviour.

and, in relation to s47:

> This proposed new threshold is the same as the threshold for these types of acquisitions in section 50 of the Trade Practices Act 1974 (Australia).

72. For the purposes of the analysis, the Commission takes the view that a lessening of competition and a strengthening of market power may be taken as being equivalent, since they are the two sides of the same coin. Hence, it uses the two terms interchangeably. Thus, in considering whether the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market, the Commission will take account of the scope for the exercise of market power, either unilaterally or through co-ordination between firms.

73. When the impact of enhanced market power is expected predominantly to be upon price, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years, for the lessening, or likely lessening, of competition to be regarded as substantial. Similarly, when the impact of increased market power is felt in terms of the non-price dimensions of competition, these also have to be both material and able to be sustainable for at least two years for there to be a substantial lessening, or likely substantial lessening, of competition.

The Counterfactual

74. The Commission will continue to use a forward-looking, counterfactual, type of analysis in its assessment of business acquisitions, in which two future scenarios are postulated: that with the acquisition in question, and that in the absence of the acquisition (the counterfactual). The impact of the acquisition on competition can then be viewed as the difference between those two scenarios. It should be noted that the status quo cannot necessarily be assumed to continue in the absence of the acquisition, although that may often be the case. For example, in some instances a clearly developing trend may be evident in the market, in which case the appropriate counterfactual may be based on an extrapolation of that trend.

75. The present state of competition in a market can be referred to in order to illuminate the future state of the market where there is a range of possible scenarios should a merger not proceed.[12]

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[11] See *Dandy*, supra n 5, pp 43–887 to 43-888 and adopted in New Zealand: *ARA v Mutual Rental Cars* [ ] 2 NZLR 647; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 2 NZLR 352; *Fisher & Paykel Ltd v Commerce Commission* [ ] 2 NZLR 731; *Commerce Commission v Carter Holt Harvey*, unreported, High Court, Auckland, CL 27/95, 18/4/00.

76. Gill is currently operating with [ ] concrete trucks after the loss of its [ ] truck over a cliff. Gill is currently posing a limited competitive constraint on Firth and Allied. [

]

77. Further suggesting Gill will remain in the market is the fact Gill's core business, gravel production, produces aggregate as a by-product and it is unlikely Gill would cease concrete manufacturing operations completely with a ready supply of aggregate on site.

78. [

]

79. No other likely purchasers of Gill's concrete assets have emerged in the course of the investigation. The most likely counterfactual is Gill maintaining a [ ] truck fleet and continuing to produce concrete for small residential and commercial jobs. There is no indication from Gill or customers in Blenheim that the business is not sustainable and it appears from customer feedback that Gill has carved out a successful market niche.

Conclusion on the Counterfactual

80. The Commission proposes to use as a counterfactual a three firm scenario where Gill, operating [ ] trucks, continues to compete against Allied and Firth for small domestic and commercial jobs.

Potential Sources of Market Power

81. Two types of market situations conducive to the exercise of substantial unilateral market power are now considered. These involve making the distinction between undifferentiated and differentiated product markets. That distinction may also have a bearing on the scope for co-ordinated behaviour in a market.

82. In undifferentiated product markets, where buyers make their purchases largely on the basis of price, and the production capacities of firms are an important element in competition, a business acquisition may have the potential to substantially lessen competition when the combined entity has acquired a market share below that required for dominance. This is especially likely in circumstances where the rivals of the combined entity cannot easily expand production to offset its output contraction within a one-year time frame.[13] The inability of rivals to expand may result either from their facing binding capacity constraints, or because additional capacity is significantly more expensive to operate.

Conclusion – Competition Analysis Principles

83. The Act prohibits business acquisitions that would be likely to have the effect of substantially lessening competition in a market. The Commission makes this assessment against a counterfactual of what it considers would be likely to happen in the absence of

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[12] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41 at paras 113 & 114.

[13] See, for example, Roger D Blair and Amanda K Esquibel, "The Roles of Areeda, Turner and Economic Theory in Measuring Monopoly Power" (1996) *Antitrust Bulletin*, 781, especially pp 791-95.

the acquisition. In the present case the counterfactual is considered to be a market where Gill operating with [ ] trucks competes against Allied and Firth for small domestic and commercial jobs. A substantial lessening of competition is taken to be equivalent to a substantial increase in market power. A business acquisition can lead to an increase in market power by providing scope either for the combined entity to exercise such power unilaterally, or for the firms remaining in the market to co-ordinate their behaviour so as to exercise such power.

84. In broad terms, a substantial lessening of competition cannot arise from a business acquisition where there are sufficient competitive constraints upon the combined entity. The balance of this Decision considers and evaluates the constraints that might apply in the Marlborough ready mix concrete market under the following headings:

- existing competition;
- potential competition from entry; and
- other competition factors.

ANALYSIS OF EXISTING COMPETITION

Introduction

85. One consequence of a merger between competitors is that the number of firms competing in a market is reduced or, put another way, concentration is increased. This raises the possibility that competition in the market may be substantially lessened through the exercise of unilateral or coordinated market power. These are the subjects of the analysis in this section.

Scope for Unilateral Market Power

Introduction

86. An examination of concentration in a market post-acquisition can provide a useful guide to the constraints that market participants may place upon each other, including the combined entity. Both structural and behavioural factors have to be considered. However, concentration is only one of a number of factors to be considered in the assessment of competition in a market. Those other factors are considered in later sections, as noted above.

87. Market shares can be measured in terms of revenues, volumes of goods sold, production capacities or inputs (such as labour or capital) used. All measures may yield similar results in some cases. Where they do not, the Commission may, for the purposes of its assessment, adopt the measure which yields the highest level of market share for the combined entity. The Commission considers that this will lead to an appropriately conservative assessment of concentration, and that the factors which lead to the other different market share results are more appropriately considered elsewhere during the assessment of the acquisition.[14]

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[14] For example, where market share measured in terms of capacity produces a significantly lower share of the market in the hands of participants than a measure in terms of sales volumes, the constraint on a combined entity from that unemployed capacity might be taken into account when identifying near entrants or the constraint

88. In determining market shares, the Commission will take into account the existing participants (including ‘near entrants’), inter-firm relationships, and the level of imports. This is followed by a specification of the Commission’s ‘safe harbours’, an estimation of market shares, and an evaluation of existing competition in the market. Each of these aspects is now considered in turn.

Existing Participants

89. There are currently three participants in the Marlborough concrete market; Firth, Allied and Gill. The proposed acquisition will remove Gill as an independent provider of ready mix concrete.

Safe Harbours

90. Once the relevant market has been defined, the participants have been identified, and their market shares estimated, the Commission’s ‘safe harbours’ can be applied. Under these safe harbours, a business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

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

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

91. As noted below, market shares by themselves are insufficient to establish whether competition in a market has been lessened. Other relevant issues are discussed in later sections.

Market Shares

92. On the basis of the preceding discussion, the Commission proposes to use cubic meters of concrete supplied annually by the participants in the market as the primary measure of market share and concentration. The resulting shares are shown in Table 1.

93. Market participants have provided their throughput figures. Market participants have warned that market shares can fluctuate from year to year depending on who wins major contracts. For example, Allied has advised that its concrete supply in the previous four years have been [ ], [ ], [ ] and [ ] cubic metres. Similarly, Firth has advised Commission staff that its annual concrete supply is around [ ] cubic metres. Commission staff have used the average volumes for each of Firth and Allied in estimating market share.

from new market entry. In some cases, the model of market power being used may influence the choice as to which market share measure is used.

Table 1:

Estimated Market Shares for the Blenheim Ready-Mix Market

Firm	**Supplied Concrete (m^3)**	**Market Share (%)**
Firth	[ ]	[ ]
Gill	[ ]	[ ]
Sub-Total	**[ ]**	**[ ]**
Allied	[ ]	[ ]
Total	**[ ]**	**100**

94. Table 1 indicates the merged entity will have market share of around [ ]%. This will place the merged entity outside the Commission's prescribed safe harbour for unilateral market power. The three firm concentration ratio is 100%, as only two firms will continue to supply ready-mixed concrete.

95. Gill has advised Commission staff that around [ ] cubic metres per year of its supplied concrete is for its own construction jobs. Therefore, Gill's market share may overstate its position in the market.

96. As already noted, market shares are insufficient in themselves to establish whether competition in a market has been lessened. It is the interplay between a number of competition factors, of which seller concentration is only one, that has to be assessed in determining the impact of a business acquisition on competition. Other competition factors include entry conditions; the presence of an aggressive, innovative or maverick firm; countervailing power of buyers or suppliers; rapid innovation in the market; and others. These are considered for the relevant market in subsequent sections.

State of Existing Competition

97. The majority of market participants spoken with do not believe Gill is an effective competitor outside of small domestic and commercial jobs. Gill does not have a sufficient number of trucks to supply the volume of concrete necessary for large jobs. Gill is currently only operating [ ] trucks so its ability to handle even domestic jobs is limited. [ ]

98. Gill is limited in its ability to compete for commercial tenders because its concrete is not NZRMCA certified, which precludes it from tendering for large commercial jobs, such as those for Transit. Major commercial jobs are done by either Allied or Firth. Gill exercises no competitive constraint on the large commercial job segment of the market.

99. Following the acquisition, only Allied will remain as a competitor. Allied has around [ ]% of the market, and is a strong player. It has advised Commission staff that it has [ ] in Blenheim. It also has a plant in Nelson from which it can borrow trucks when demand necessitates. It therefore has the ability to easily expand supply in the market.

100. Allied and Firth compete for both residential and commercial segments of the concrete market in Marlborough. Concrete producers in both Marlborough and Nelson

point to the importance of a concrete firm serving as many segments and job types as possible as a downturn in one segment is a common occurrence. Gill does not have this advantage as it can service only small residential and commercial jobs with its limited truck numbers.

101. A number of contractors believe that the acquisition will strengthen Firth as a competitor against Allied. [ ] By moving to the Gill site Firth will be able to begin manufacturing and delivering concrete [ ]. Firth also intends to purchase Gill's concrete trucks, increasing its ability to deliver greater quantities of concrete.

102. The argument that Firth's acquisition will allow it to compete with Allied in the commercial market understates the degree of competition Firth currently presents to Allied. While Firth will improve its ability to compete against Allied by occupying a site without a constraint on [ ] even at its present site Firth is able to exercise a considerable competitive constraint on Allied. While Firth is somewhat limited by zoning restrictions, its [ ]-truck fleet allows it to compete vigorously in both domestic and commercial segments. Recognising Firth's statement in paragraph 78 [ ], the Commission does not give much weight to their argument that the acquisition is necessary to overcome [ ]

103. A number of contractors interviewed did not agree with the notion that Firth currently does not compete for commercial jobs. [ ] sources concrete from both Allied and Firth and believes Firth is a competitor in the commercial as well as domestic segments of the market. [ ] Allied and Firth are competitive throughout New Zealand where they are both in the same market and believes the Marlborough market is no different. [ ] that to compete with Allied or Firth, a firm needs at least three trucks.

104. [ ] currently sources concrete exclusively from Allied but noted it would be easy to get a quote from Firth if necessary. [ ] requires so as far as he is concerned there are only two options for concrete—Allied and Firth. When asked about the effects of the acquisition on the market [ ] that concrete is "bloody" cheap in Blenheim and he is not concerned one way or the other with Gill's removal as an independent player.

105. Concrete is essentially undifferentiated, and market buyers have expressed an indifference between using Firth or Allied. It is therefore considered unlikely that Firth would be able to unilaterally raise prices above competitive levels or offer a lesser service over any reasonable period of time, without losing significant business to Allied.

Conclusions – Unilateral Market Power

106. Gill is not currently posing a significant competitive restraint on either Allied or Firth for large domestic or commercial jobs. Both manufacturers and buyers of concrete have indicated the removal of Gill will not change existing conditions in the large domestic and commercial job segment. The market in the large job segment is essentially a two firm market, on this basis the removal of Gill will not lead to an increase in Firth's market

power in the event the acquisition proceeds. In the small jobs segment of the market Gill is an active competitor. However, it is at this end of the market that new entry is relatively easy and a number of entrants have expressed a willingness to enter if Gill ceases to operate as a concrete manufacturer. A new entrant can quickly replace any loss of competitive constraint due to Firth's acquisition of Gill.

Scope for the Exercise of Coordinated Market Power

Introduction

107. A business acquisition may lead to a change in market circumstances such that coordination between the remaining firms either is made more likely, or the effectiveness of pre-acquisition coordination is enhanced. Firms that would otherwise compete may attempt to coordinate their behaviour in order to exercise market power by restricting their joint output and raising price. In extreme cases, where all firms in the market are involved and coordination is particularly effective, they may be able to behave like a collective monopolist. Where not all firms are involved, and market share in the hands of the collaborators is reduced, coordinated market power becomes more difficult to exercise because of competition from the independent firms in the market.

108. In broad terms, successful coordination can be thought of as requiring two ingredients: 'collusion' and 'discipline'. 'Collusion' involves the firms individually coming to a mutually profitable expectation or agreement over coordination; 'discipline' requires that firms that would deviate from the understanding are detected and punished (thereby eliminating the short-term profit to be gained by the firm from deviating).

109. When assessing the scope for coordination in the market during the consideration of a business acquisition, the Commission will evaluate the likely post-acquisition structural and behavioural characteristics of the relevant market or markets to test whether the potential for coordination would be materially enhanced by the acquisition. The intention is to assess the likelihood of certain types of behaviour occurring, and whether these would be likely to lead to a substantial lessening of competition.

Collusion

110. "Collusion" involves firms in a market individually coming to a mutually profitable expectation or agreement over coordination. Both explicit and tacit forms of such behaviour between firms are included.

111. The structural and behavioural factors that are usually considered to be conducive to collusion are set out in the left-hand column in Table 2. The significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of the Table then assesses the extent to which those factors are present, or are likely to be enhanced post-merger, in the ready mix market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'collusion'; a high proportion of 'no' responses the reverse.

TABLE 2
Testing the Potential for 'Collusion' in the Ready Mix Concrete Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes
Undifferentiated product	Yes
New entry slow	No
Lack of fringe competitors	Yes
Price inelastic demand curve	Yes
Industry's poor competition record	Yes
Presence of excess capacity	Yes
Presence of industry associations/for a etc	Yes

112. As noted earlier, the post-transaction concentration ratio is 100% since only Firth and Allied will remain in the market with respective market shares of [ ]% and [ ]%. Therefore, not only is the market highly concentrated,[

] It might be argued that a clear division cannot be enforced since the market shares are not observable; however market participants may be able to gauge an opponent's output through observable "proxy" measurements such as the number of capital units actively engaged – in this market the number and size of concrete trucks may provide such a proxy.

113. The product is essentially undifferentiated. The quality assurance standards imposed by the NZRMCA are likely to enhance the ability to coordinate because it establishes uniform quality standards. By abiding to these standards the two firms produce an essentially homogeneous product. Therefore quality issues would not arise if the two firms sought to fix prices.

114. New entry is not likely to be slow; Alan Stevens of Firth told Commission staff that a new plant could be set up within a three-month time span and other players in the market have confirmed this. Finding appropriately zoned land does not seem overly difficult in Blenheim and vehicles and other necessary plant and equipment can be acquired and assembled in a relatively short time frame. However, although entry can be achieved quickly, some barriers would appear to exist – these are discussed further in the "Conditions of Entry" section below.

115. Some builders mix concrete for their own requirements and so it could be argued that they are fringe competitors. These builders mix concrete for use on such things as driveways and footpaths. However the quantities involved are very small in relative terms and certainly no constraint against the likes of Firth and Allied. There is a large step up in investment required before such builders could compete for construction jobs involving pouring foundations or other projects requiring large, or even medium, quantities of concrete. It is therefore unlikely that these "fringe competitors" would have any significant influence on the market.

116. There are no close substitutes for concrete. Concrete is an essential product for building foundations, bridges, and other constructions. It is likely that demand for concrete is inelastic. Prices could therefore be raised without affecting demand significantly.

117. [ ]

118. Allied and Firth are both members of the NZRMCA. [ ] Their membership in this organization may provide a forum in which Allied and Firth could communicate to each other.

119. Buyers of concrete have not expressed any concerns over possible price coordination between Allied and Firth. However it is telling that one of [ ] was less concerned with a uniformly higher price of concrete, which could be passed through to end users, than with different prices offered to his competitors which may make his bid for a given job relatively less competitive.

120. [ ] has observed that, even though only Allied and Firth compete for its large construction jobs, the competition is vigorous. [ ]

121. In interviews with market participants in the Nelson/ Motueaka area [ ]

122. [ ]

123. In an interview with Commission staff [ ].

Conclusion on Collusion

124. Most of the characteristics of the market would appear to facilitate collusion and this was confirmed during the investigation. However, Commission staff failed to establish a connection between the proposed transaction and a likelihood of substantially increased collusion in the market. The reasoning is based on the small scale of capacity that Gill has been operating at, and new entrants are likely to achieve, because of the economies of

scope enjoyed by larger operators (see Barriers to Entry). This ceiling on capacity (usually in trucks) holds smaller players to a maximum[15] output that is a small [ ] share of the market. This capacity constraint for smaller players would arguably enable larger operators to work, possibly in a collusive manner, to the residual (substantially unaffected) market demand.

Discipline

125. For coordination to be successful, deviations of individual firms from the collusive behaviour have to be discouraged by being detected swiftly and punished by the other colluding firms. Such 'punishment' is typically understood to take the form of driving price to its competitive level and so depriving suppliers in the market of excess profits.

126. Formal analyses of strategies in oligopolistic markets indicate that prices can be held stable above competitive rates by the threat of discipline when suppliers face each other in a market over an indefinite number of periods.[16] Moreover, such models predict a possible observable outcome to be where periods of price stability are interspersed with episodes of strong competition and price cutting behaviour. Such episodes are punishment of one supplier by others for deviating from the collusive behaviour exhibited during the stable period.[17]

127. The structural and behavioural factors that are usually considered to be conducive to 'discipline' in co-ordinated markets are set out in the left-hand column in Table 3. Again, the significance of these is explained more fully in the Commission's *Practice Note 4*. The right-hand column of Table 3 then assesses the extent to which those factors are present, or are likely to be enhanced post-acquisition, in the ready mix concrete market. A high proportion of 'yes' responses would suggest that the market was particularly favourable to 'discipline; a high proportion of 'no' responses the reverse.

TABLE 3
Testing the Potential for "Discipline" in the Ready Mix Concrete Market

Factors conducive to discipline	Presence of factors in the market
High seller concentration	Yes
Sales small and frequent	No
Absence of vertical integration	Yes
Demand slow growing	No
Firms have similar costs	Yes
Price transparency	Yes –[ ]

[15] In fact it is the Commission's observation that small players in concrete markets do not typically seek to operate at their maximum scale but are usually price-followers of the large operators.
[16] See Dennis W. Carlton and Jeffrey M. Perloff, "Modern Industrial Organisation" (1994) Chapter 7 under the heading *Infinitely Repeated Prisoners' Dilemma Game*.
[17] See Jean Tirole, "The Theory of Industrial Organisation" (1988), Section 6.7.3.

128. As noted previously, there is a high seller concentration. There will be only two firms in the market (therefore the concentration ratio is 100%). A high concentration ratio facilitates discipline because there are few firms that require monitoring.

129. As already noted, the two national ready-mixed concrete firms, Firth and Allied, are vertically integrated with cement companies Golden Bay and Milburn respectively. These two firms account for about [ ] of national ready-mix concrete production, with Firth estimating its share as [ ], and Allied's share being estimated at [ ]

130. A small number of [ ]sales cannot be classified as being "small and frequent". In general, the nature of sales is lumpy – contracts range in size and frequency. This is one reason why volumes vary from year to year. Winning large contracts can make a significant difference to annual turnover.

131. Most concrete sales are made to contractors. In Blenheim neither Firth or Allied is vertically integrated with any contractors.

132. The demand for concrete is likely to fluctuate, with significant downturns associated with slumps in new investment in construction. Currently, the Marlborough region is experiencing increased demand for concrete driven by expansion in the wine industry and domestic house construction.

133. The market participants have advised that pricing is done in three ways:

- A price list for small retail jobs
- Discount price for regular customers
- Tender for large commercial contracts.

134. It appears from conversations with [

]

135. [

] Such observed behaviour is consistent with models wherein high prices are maintained in a market through collusion and the credible threat of discipline.

Conclusion on Discipline

136. With Gill only able to compete for small domestic and commercial jobs, Allied and Firth are currently able to potentially collude on prices for large domestic and commercial projects. The presence of Gill in the market does not appear to affect the success or failure of efforts by Firth or Allied to successfully impose discipline. For this reason the Commission believes it is unlikely the acquisition will increase the likelihood of effective discipline in the ready mix concrete market.

Conclusion on Coordinated Market Power

137. While many factors conducive to collusion are present, there appears to be no linkage between the removal of Gill from the market and a substantial increase in the coordinated market power of Firth and Allied. The speed of new entry by a small operator makes it unlikely that a substantial increase in collusive behaviour would be sustainable for a long period of time in the small domestic and commercial job segment.

CONSTRAINTS FROM MARKET ENTRY

Introduction

138. A business acquisition is unlikely to result in a substantial lessening of competition in a market if behaviour in that market continues to be subject to real constraints from the threat of market entry.

139. Where barriers to entry are clearly low, it will not be necessary for the Commission to identify specific firms that might enter the market. In other cases, the Commission will seek to identify likely new entrants into the market.

140. The Commission will consider the history of past market entry as an indicator of the likelihood of future entry. The Commission is also mindful that entry often occurs on a relatively small scale, at least initially, and as such may not pose much of a competitive constraint on incumbents within the relevant time frame.

Barriers to Entry

141. The likely effectiveness of the threat of new entry in constraining the conduct of market participants, following a business acquisition that might otherwise lead to a substantial lessening of competition in a market, is determined by the nature and height of barriers to entry into that market.

142. The Commission considers that, for the purpose of considering this issue, a barrier to entry is best defined as an additional or significantly increased cost or other disadvantage that a new entrant must bear as a condition of entry. In evaluating the barriers to entry into a market, the Commission will generally consider the broader ‘entry conditions’ that apply, and then go on to evaluate which of those constitute entry barriers.

143. It is the overall obstacle to entry posed by the aggregation of the various barriers that is relevant in determining whether entry is relatively easy or not, and therefore whether or not potential entry would prevent a substantial lessening of competition.

144. For entry to act as an antidote to a substantial lessening of competition stemming from a business acquisition, it must constrain the behaviour of the combined entity and others in the market.

145. In Decision 416 the Commission did not assess barriers to entry in the ready mix concrete market in Nelson as existing competition was determined to act as an effective constraint.

Access to Suitable Sites

146. Suitable commercial sites for establishing a concrete facility are readily available in the Marlborough region. The Marlborough District Council confirmed the figure of 163.75 hectares of commercially zoned land cited by Firth as available for a concrete plant.

Resource Consents

147. The ability of a new entrant to obtain the necessary resource consents to operate a concrete batching plant is not difficult. The Marlborough District Council noted the major issues for a concrete plant are water runoff from washing the concrete trucks, airborne cement dust and appropriate safety systems to contain a spill in the event of a cement or concrete spillage. The District Council believes that dealing with these resource consents issues in a suitably zoned site is straightforward.

Economies of Scope

148. Concrete is used primarily in construction, and hence its demand is very sensitive to the level of construction activity. Construction is typically categorised as investment spending which itself is positively correlated with, but substantially more variable than, economic growth. So construction activity tends to fluctuate more than output as a whole, and hence so does the demand for concrete.

149. Where such fluctuations in demand are specific to a region or regions (i.e. regional demand shifts are independent rather than being due to general, national effects), concrete firms with a presence in a number of regional markets enjoy a cost advantage over those that do not. Such firms are able to move trucks, which represent a substantial proportion of a concrete firm's fixed costs, from a relatively low demand area to one where there is temporarily high demand. It is likely that such cost advantages make entry at, or expansion to, that part of the market supplying larger jobs, difficult for those firms without a national or multi-regional presence.[18]

150. Such a cost advantage is most accurately described as an *economy of scope*. This usually describes a production function in which the production of several different products by the same firm is less costly than if those products are produced by separate firms. The analysis of the cost of producing the same product across different (geographical) markets, where costs can be shared (as is the case with concrete), is identical[19].

Capital Requirements

151. A new entrant seeking to duplicate the size of Gill's existing business requires a relatively small capital investment. A new entrant seeking to duplicate the scale of Firth or Allied would require a considerable increase in capital required due to Firth and Allied's ability to source trucks from plants located in nearby regions. It is doubtful a

[18] This effect favouring multi-regional operators is quite general, applying also for example in the case of otherwise small markets where large contracts may come up occasionally.
[19] See, for example, Dennis W. Carlton and Jeffrey M. Perloff, "Modern Industrial Organisation" (1994) Appendix 3B.

new entrant, operating independently, would be willing to invest in the truck assets required as they would not have the ability to move their fleet from low to high demand areas.

Availability of Aggregate

152. New entrants in the ready mix concrete market require access to aggregate supplies or a third party supplier. Aggregate supplies are readily available in the Marlborough region from rivers. The Marlborough District Council has indicated certain areas of river may run out of supply in two to three years. However, upriver from these sites an abundant supply still exists and the Council indicates permits to extract the aggregate are readily available.

153. A new entrant could also elect to source aggregate from a number of gravel firms in the Marlborough region.

Conclusion on Barriers to Entry

154. Entry at the scale of Firth or Allied's operation is problematic for a new entrant due to large capital requirements and an inability to capture similar economies of scope that Allied and Firth enjoy as part of national firms. Entry at the scale of duplicating Gill's operation is relatively easy for a new entrant as there are no significant barriers to entry.

The "LET" Test

155. In order for the threat of market entry to be such a constraint on the exercise of market power as to alleviate concerns that a business acquisition could lead to a substantial lessening of competition, entry of new participants in response to the exercise of market power must be likely, sufficient in extent and timely (the *let* test). If they are to act as a constraint on market participants following a business acquisition which might otherwise lead to a substantial lessening of competition in a market, entry must be relatively easy, or to put it another way, barriers to entry must be relatively low.

Likelihood of Entry

156. The mere possibility of entry is, in the Commission's view, an insufficient constraint on the exercise of market power to alleviate concerns about a substantial lessening of competition. In order to be a constraint on market participants, entry must be likely in commercial terms. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on its investment, including allowance for any risks involved.

157. In general, it is the pre-merger price that is relevant for judging whether entry is likely to be profitable. That in turn depends upon the reaction of incumbents to entry in terms of their production volume, together with the output volume needed by the entrant in order to lower its unit costs to the point where it can be competitive.

158. The Applicant has cited the following firms as potential providers of concrete:

- Concrete & Metals Motueka Limited;

- CJ Industries;
- G R Lawrence Limited
- NZ Aggregates limited;
- Gravel Supplies;
- Crafar & Crouch;
- Works Infrastructure.

159. With the exception of [ ], none of the above firms expressed any desire to enter the Marlborough concrete market.[20] [ ] believes the market can only sustain two players and Gill's removal is a rationalisation of the market. [ ]

160. Gravel Supplies currently [ ] believes it would take an investment of $500,000 to enter effectively. [ ]

161. [ ] Even with Fulton Hogan committed to supplying Allied with aggregate and Gill committed to supplying Firth, new entrants would have the ability to source aggregate from a third party or set up their own operation at the river.

162. The Marlborough District Council has indicated the supply of gravel in the section of river where Gravel Supplies and Gill operate their fixed plants is running out. As a result the Council reduced the annual quota of gravel from 10,000 m^3 to 7,000m^3. The Council believes it may have to reduce this quota further in the next two to three years if there is no flooding, which rejuvenates the supply of gravel in that section of river. Upriver there is still a plentiful supply of gravel. Fulton Hogan currently extracts [ ] annually from this site. Both Fulton Hogan and the Council believe it would be straightforward for a new entrant to locate a gravel extraction site in an upriver location. There appears no constraint on the supply of gravel for a new entrant seeking to establish a concrete operation.

[20] Commission staff were not able to contact G R Lawrence to determine whether the company is a likely entrant.

163. [ ], not listed by Firth as a potential entrant, indicated he would consider entering if Allied and Firth raised concrete prices. [ ] that if Gill leaves the market there are always players “looking to make a quid” in a new operation.

164. [

]

165. In the mid 1980’s T.H Barnes, a Blenheim contractor, won the bid for a major construction project located 40 kilometres from the main suppliers of concrete. In order to reduce the cost of transporting concrete over the long distance, Barnes set up a mobile concrete batching plant at the job site. By leasing most of the necessary equipment, the cost of the batch plant was estimated at $10,000. Mr. Barnes noted that it would take a substantial increase in the price of concrete to cause him to consider producing his own concrete for jobs closer to town.

166. Estimates of the costs to enter the concrete market range from $10,000 for leasing a mobile batching plant up to $750,000 to purchase new trucks and a batching plant. Most industry participants spoken with agreed a mid level investment of $250,000 would allow a new entrant to purchase two trucks and the necessary batching equipment.

167. Entry with either a mobile or fixed batching plant is feasible and several players have expressed interest. In other concrete markets in New Zealand small players have entered the market and competed against Allied and Firth. Porirua Ready Mix (PRM) entered the Wellington market in 1997 and currently holds a [ ] market share. PRM operates three trucks and spent [ ] to set up operations with about [ ] upfront. The capital outlay to establish an operation is not that great and it appears firms with a small market share can sustain a market presence.

168. Recent entrants into other concrete markets in New Zealand emphasise that to be successful in concrete a new entrant must have a diversified business strategy or a strong financial backer. [ ] cited heavy price reductions by existing players in an attempt to price them out of the market. [ ] noted that if you have the necessary financial resource or can rely on other types of business to support you during this period of price-cutting then it is likely prices will return to average levels in six months.

169. The situation [ ] currently faces means they are highly likely to enter the Marlborough market if Firth takes over Gill’s site. While established players in concrete markets can make new entry difficult, the 21 new entrants in concrete markets around New Zealand since 1996 indicate entry is both possible and sustainable in concrete markets.

170. The Nelson-Marlborough region is currently experiencing strong economic growth with high levels of demand for new housing and vineyards. Overall, economic activity in the region rose for the sixth consecutive quarter. On an annual economic growth basis the Nelson-Marlborough region has consistently surpassed the national average for the past three years. A National Bank survey indicates that the Nelson-Marlborough region's

economy grew 5.1% in the year to March 2002. The region also had the largest rise in commercial building permits, and building approvals for dwellings increased sharply. The Nelson-Marlborough region recorded its largest quarterly rise in economic activity in more than two years, the survey said. The latest figures were an improvement on Nelson-Marlborough's 4.8% increase in economic activity for the year to December 2001. Current economic growth in the Marlborough region makes it likely that a new entrant in the concrete market would have sufficient demand for concrete to sustain operations.

171. A number of participants in the Marlborough concrete market have indicated a willingness to enter with the removal of Gill as an independent party. The cost of entry to replicate Gill's scale is minimal and can be further reduced using second hand equipment and mobile batching units. While Allied and Firth may reduce prices in an attempt to push new entrants out of the market, small concrete firms in markets similar to Marlborough have successfully sustained profitable operation in the face of considerable price competition. These factors combined with the current economic conditions in the Marlborough region create a market where new entry is likely.

Extent of Entry

172. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to cause market participants to react in a significant manner. The Commission will not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.

173. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that "toe-hold" position may be difficult because of the presence of mobility barriers, which may hinder firm's efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.

174. The Applicant suggests that a firm gaining a 10% market share could make entry into the concrete market. According to Firth entry of this size would cost an estimated $380,000. Entry of this size means a firm would be limited in its ability to compete for large commercial jobs. A new entrant would attempt to compete for small domestic and commercial jobs with two to three trucks. A bigger fleet of trucks is needed in order to service the larger volume demands of big domestic and commercial projects.

175. It is unlikely a new entrant would attempt to compete against Allied and Firth for major projects. The national network these companies possess allows them to shift trucks from low demand areas to high demand areas when necessary. This flexibility would not be available to an independent firm operating a five to six truck fleet in the Marlborough region. In the event of an economic downturn in the Marlborough region an independent firm would be unable to shift resources to weather the drop in demand.

176. While a new entrant could readily increase its concrete volume by increasing its truck numbers it is unlikely the firm would be willing to take the risk of demand dropping and having expensive truck assets sitting unused. Not having the ability to move trucks around regionally discourages a small entrant from attempting to expand capacity to compete with the likes of Allied and Firth.

177. Entry to the degree of duplicating the Allied or Firth sized operations is unlikely in the Marlborough region. However, a new entrant could quickly establish a level of operation similar to that of Gill and vigorously compete for the small domestic and commercial jobs available in the market.

Timeliness of Entry

178. If it is effectively to constrain the exercise of market power to the extent necessary to alleviate concerns about a substantial lessening of competition, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.

179. In some markets where goods and services are supplied and purchased on a long-term contractual basis, buyers may not immediately be exposed to the detrimental effects stemming from a potential substantial lessening of competition. In such cases, the competition analysis, in a timing sense, begins with the point at which those contracts come up for renewal.

180. The applicant submitted entry could be affected within a two to three month period. As evidence, Alan Stevens, the manager of Firth in Blenheim, cited his experience with setting up a new concrete facility in Nelson. Mr. Stevens was able to go from green fields to a working plant in three months Market participants interviewed agreed with this estimate and noted it would not be difficult to source the necessary equipment as trade magazines consistently advertise both new and used concrete trucks and equipment. Securing the necessary supply of aggregate would also be relatively simple, as a number of suppliers exist. In particular, [

]

Conclusion on Constraint from Potential Entry

181. The Commission concludes that potential entry of the scale to service small-scale domestic and commercial concrete jobs meets all the requirements of the LET test. A new firm can enter the concrete market and pose a competitive constraint on Firth and Allied in the provision of concrete to small domestic and commercial jobs, equal to that posed by Gill.

OTHER COMPETITION FACTORS

Elimination of a Vigorous and Effective Competitor

182. Sometimes an industry contains a firm that is in some way non-typical, or has different characteristics, or is an innovator, or is regarded as a maverick. The independent or less predictable behaviour of such a firm may be an important source of competition in the market, and may undermine efforts by other firms to engage in coordination. Such a firm need not be large to have an impact on competition out of proportion to its relative market size. Should it become the target of a business acquisition, the resulting elimination of a vigorous and effective competitor could have the effect of substantially lessening

competition in the market (especially if there are barriers preventing the entry of new, effective competitors).

183. With Gill only operating [ ]trucks it is forced to service only the smallest residential and commercial jobs. Neither Allied or Firth regards Gill as representing a serious competitor in either the domestic or commercial segments of the market. Gill is currently posing no competitive constraint on the actions of Allied or Firth for larger jobs. Some market participants have indicated they believe Gill acts as a price leveller by being in the market. They feel that while Gill is only able to compete for small jobs this acts as a restraint on the pricing behaviour of the two larger firms.

Conclusion on Other Competition Factors

184. However, since Gill is not a vigorous or effective competitor for large domestic or commercial jobs the acquisition of Gill does not remove an important source of competition from the market. As noted in the barriers to entry section above, a new entrant could quickly fill any gap left in the small domestic and commercial job segment of the market by Gill's removal. Therefore, the Commission does not believe the acquisition will result in the removal of a vigorous or effective competitor.

Constraint from Buyers or Suppliers

185. The potential for a firm to wield market power may be constrained by countervailing power in the hands of its customers, or alternatively, when considering buyer (oligopsony or monopsony) market power, its suppliers. In some circumstances, it is possible that this constraint may be sufficient to eliminate concerns that a business acquisition may lead to a substantial lessening of competition.

186. Where a combined entity would face a purchaser or supplier with a substantial degree of market power in a market affected by the acquisition, the Commission will consider whether that situation is such as to constrain market participants to such an extent that competition is not substantially lessened.

187. Contractors indicate their ability to go to Firth or Allied gives them some leverage in getting a fair price for concrete. The larger contractors in Blenheim believe the volume they use annually gets them better prices for concrete than small builders. [ ] spent [ ] last year on concrete and feel they get a better price from [ ] on concrete because of the volume they use.

188. When asked how they would respond to increases in concrete prices from Firth and Allied most contractors replied they would probably just pass the increase down to the end user. Contractors were more concerned that whatever prices they were paying for concrete, their competitors were paying the same. Contractors compete vigorously for projects and differences in concrete prices could affect the competitiveness of bids for contracts.

189. While volume discounts and the threat of switching providers are features of the market, the ease with which contractors can pass on price increases in concrete to end users suggests they are unlikely to exercise substantial countervailing power.

Efficiencies

190. The Commission recognises that there may be circumstances where efficiencies are relevant to an application for clearance.[21] In the context of a business acquisition, the combined entity might be able to make efficiency gains that are not obtainable by other means, such that its unit cost of production would decline. This could result in the entity reducing its price below that obtaining prior to the acquisition, even though with the acquisition it would otherwise be considered to have substantially lessened competition, and would be able to raise price above costs.

191. Where the applicant can make a sound and credible case that such efficiencies will be realised, that they cannot be realised without the acquisition, and that they will enhance competition in the relevant market, the Commission will include them in the broader analysis of all of the competitive effects of the acquisition in the course of assessing whether or not competition is likely to be substantially lessened. However, the Commission envisages that efficiency claims of the required magnitude and credibility will only very rarely overturn a finding that competition would otherwise be substantially lessened.

192. The Applicant has cited the acquisition as improving its ability to compete for commercial projects, [ ] Some contractors believe this will allow Firth to become a viable alternative to Allied for large commercial projects. However, other contractors believe that Firth is currently a viable choice for commercial projects. The Applicant can achieve the same result the acquisition delivers[ ] by building on a new site with [ ]

193. The difference in customer opinion weakens any efficiency argument proposed by the Applicant. If some customers believe Firth currently poses a competitive alternative to Allied for commercial projects then the efficiency argument is not strong enough for the Commission to give it weight in offsetting any potential lessening of competition that might arise post-acquisition.

OVERALL CONCLUSION

194. The Commission has considered the probable nature and extent of competition that would exist in the Marlborough market for ready mix concrete. The Commission considers that the appropriate benchmark for comparison is a scenario where Gill operates [ ] concrete trucks and continues to function alongside Allied and Firth as an independent provider of ready mix concrete.

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[21] In *Fisher & Paykel*, considered under s 27, the Court held that in assessing “substantial lessening of competition”, a net approach to assessing anti-competitive effects was required: “The majority correctly accepted that it had to ‘net out’ the pro and anti-competitive effects and that, if it could be shown that the net effect of the EDC was to promote competition, then there could be no substantial lessening of competition.” *Fisher & Paykel v Commerce Commission* [ ] 2 NZLR 731 at 740. See also: *Commerce Commission v Port Nelson*, supra n 6,433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463, 531.

195. The Commission has considered the nature and extent of the contemplated lessening. The proposed acquisition would result in the merged entity obtaining a market share which falls outside the Commission's safe harbour guidelines.

196. The Commission has also considered the nature and extent of the contemplated lessening, in terms of the competitive constraints that would exist following the merger from:

- existing competition;
- potential competition from entry; and
- other competition factors.

197. The proposed acquisition would not result in the merged entity obtaining a level of unilateral market power in the Marlborough ready mix concrete market that would result in a substantial lessening of competition.

198. The proposed acquisition would not result in the merged entity obtaining a level of coordinated market power in the Marlborough ready mix concrete market that would result in a substantial lessening of competition. The Commission is therefore satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the market for the supply of ready mix concrete in the Marlborough region. The key issue is that there are no barriers to entry for a company to replicate the limited constraint provided by Gill.

DETERMINATION ON NOTICE OF CLEARANCE

199. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Firth Industries (together with its subsidiaries and related companies), to purchase the ready mix concrete business of Gill Construction Co Limited.

Dated this 26th day of July 2002