Public Version
ISSN NO. 0114-2720
J5393

COMMERCE COMMISSION

Decision No. 469

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

CONSOLIDATED EXTRUSIONS PTY LIMITED

and

MCK GROUP LIMITED

The Commission: John Belgrave
Peter Taylor
Denese Bates - QC

Summary of Application: The acquisition by Consolidated Extrusions Pty Limited (Consolidated Extrusions), a joint venture between Austral Bronze Limited (a wholly owned subsidiary of Crane Group Limited) and Simsmetal Limited, or any interconnected body corporate of Consolidated Extrusions, of those business assets of MCK Group Limited and MCK Pty Limited (together MCK) relating to the brass and copper alloy extrusions and distribution business of MCK.

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: 14 August 2002

CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN SQUARE BRACKETS

CONTENTS

THE PROPOSAL

1. On 11 July 2002 Consolidated Extrusions Pty Limited, a joint venture between Austral Bronze Limited (a wholly owned subsidiary of Crane Group Limited) and Simsmetal Limited, registered a notice with the Commission seeking clearance under s66(1) of the Commerce Act 1986 for the proposed acquisition by Consolidated Extrusions or any interconnected body corporate of Consolidated Extrusions, of those business assets of MCK Group Limited and MCK Pty Limited (together MCK) relating to the brass and copper alloy extrusions and distribution business of MCK.

2. MCK is part of the MCK group, based in Australia. MCK New Plymouth was formed in 1998 as a result of a management buyout of Mckechnie Pacific (a company formed in the 1950s). MCK is a copper and brass extruder. It produces and distributes solid and hollow brass, copper alloy rod, brass bars, and brass wire. Around 90% of MCK's product is exported.

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. An extension of time was sought by the Commission and agreed to by the applicant. Accordingly, a decision on the application was required by 14 August 2002.
4. In its application, Consolidated Extrusions 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

Consolidated Extrusions

7. Consolidated Extrusions is an Australian incorporated company and is owned as to 33.3% by Simsmetal Limited and 66.6% by Crane (through its wholly owned subsidiary Austral Bronze Crane Copper Limited).
8. Crane is also an Australian publicly listed company, with a widely dispersed shareholding. Crane holds 100% of the shares in Mico Wakefield Limited ('Mico Wakefield'), and 75% of the shares in Iplex Pipelines New Zealand Limited.

---

[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.

MCK

9. MCK was formed in 1998 as a result of a management buyout of Mckechnie Pacific (a company formed in the 1950s) with venture capital shareholdings of approximately 88%. These investors have sought to realise on their investment by a trade sale of the whole or a part of MCK's business. MCK's copper tube business was sold in June 2002 to MM Kembla New Zealand Limited.

10. The business Crane is acquiring is MCK's solid and hollow brass and copper alloy rod, sections, bar and wire production and distribution business. These products are manufactured at MCK's New Plymouth factory. MCK distributes its products in New Zealand and Australia, and also exports to a number of countries.

11. [ ]

12. MCK also manufactures and distributes aluminium extrusions, shower screens and wardrobe doors and brass and bronze components and automotive components. MCK intends to continue its focus on aluminium production post acquisition.

OTHER RELEVANT PARTIES

Mico Wakefield

13. Mico Wakefield is a wholly owned subsidiary of Crane Group Limited (Crane), an Australian publicly listed company. Mico Wakefield is a supplier of plumbing, electrical (trading as Corys Electrical) and metal (and related electrical and plumbing) products. It has 87 branches throughout New Zealand.
14. Post-acquisition, Mico Wakefield will be appointed by MCK Pacific Pty Limited (trading as AW Fraser) as its exclusive distributor of brass hollow rod of less than 2½ inch diameter in New Zealand. AW Fraser will continue to distribute hollow bronze extrusions, machined components and bearings.

Crane

15. Crane is a manufacturer and distributor of non-ferrous metal products and plastic pipeline systems, and distributor of plumbing supplies, with operations in Australia, New Zealand and Singapore. Crane manages the Consolidated Extrusions business.

Simsmetal

16. Simsmetal Limited is an Australian based metals recycling, resource recovery and industrial services group. Simsmetal Limited's presence in the relevant New Zealand markets is only through the Consolidated Extrusions joint venture.

AW Fraser

17. AW Fraser, a member of the MCK group, is a machining based organisation that extrudes primarily for its own use. Post acquisition it will remain as a separate entity. [ ] lead the Commission to consider Consolidated Extrusions and AW Fraser to be associated. The Commission will therefore aggregate the market shares of AW Fraser and Consolidated Extrusions for the purposes of competition analysis.

INDUSTRY BACKGROUND

18. Brass and copper alloy extrusions are made primarily from recycled industrial and demolition scrap. Once extruded, brass rods are on-sold to forgers and engineers which then manufacture products such as door handles, light fittings, and other components for the plumbing, gas, electrical, and furniture industries.

19. Due to a decrease in manufacturing, the New Zealand market for brass and copper alloy extrusions is in decline. Domestic producers of alloy and the finished products are also experiencing increased import competition from imported alloy, components, and finished products. The total New Zealand market for brass and copper alloy extrusions is around 4,000 tonnes per annum.

20. As a result of the decrease in demand and the substantial capacity of extrusion plants overseas, Australasia is currently experiencing surplus manufacturing capacity. This is in line with a worldwide overcapacity of aluminium, copper tube, and brass.

21. Around half of all New Zealand's brass and copper alloy extrusion requirements is currently imported, mostly from Australia via Consolidated Extrusions. Imports from outside of Australia are subject to a 7% tariff.

MARKET DEFINITION

22. 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.*

23. 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.

24. 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.
25. 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).

26. 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.
27. 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.
28. The applicant submits that the market that will be affected by the proposed acquisition is the market in New Zealand for the supply of brass and copper alloy extruded products.

Product Dimension

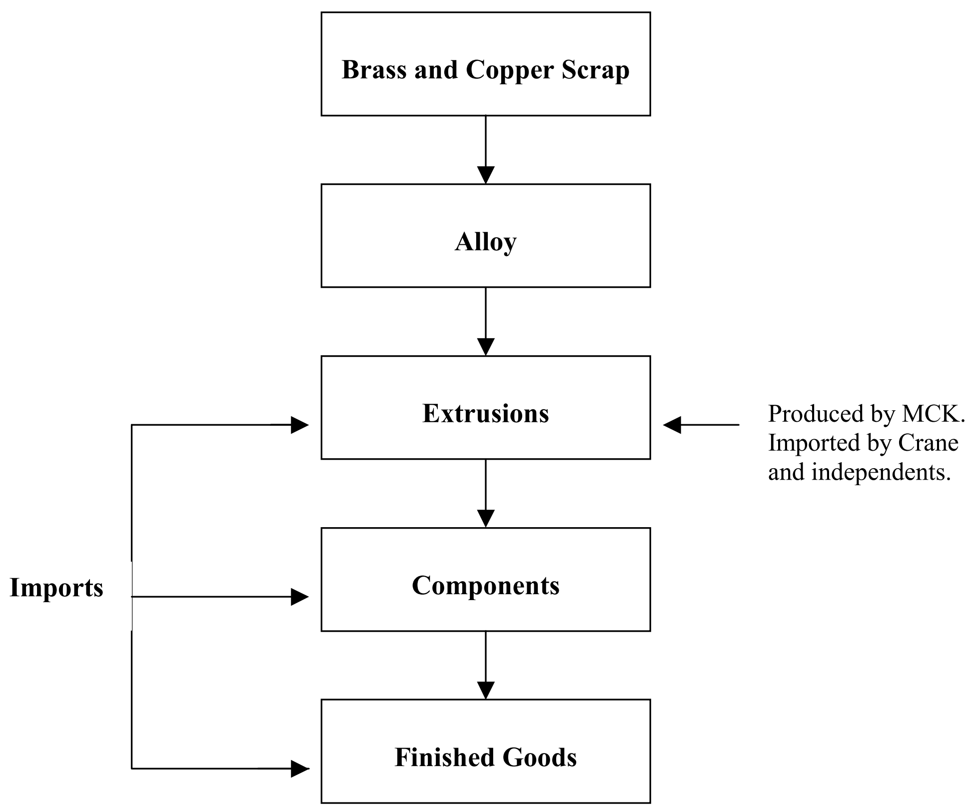
29. The delineation of relevant markets as a basis for assessing the competitive effects of a business acquisition begins with an examination of the goods or services offered by each of the parties to the acquisition. Both demand-side and supply-side factors are generally considered in defining market 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 products on the supply-side.
30. The Commission takes the view that the appropriate time period for assessing substitution possibilities is the longer term, but within the foreseeable future.[2] The

---

[2] In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [ ] 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.

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.

Figure 1: The Copper and Brass Market



31. Figure 1 illustrates the various stages in the production of copper and brass products. A large percentage of brass and copper alloy is produced from demolition and industrial scrap, which is traded on the world market. Export markets drive scrap prices. MCK is a major purchaser of scrap in New Zealand. Scrap is also imported from Australia and China as well as exported from other countries. [ ]

32. Scrap is then processed into Alloy and extruded for further processing into components to be manufactured into finished goods. MCK is New Zealand's only domestic brass and alloy extruder. It purchases scrap metal, melts it into an alloy,

and extrudes it into brass rod and brass wire. This is the business unit that Consolidated Extrusions wish to purchase.

33. Because the proposed acquisition concerns the production of brass and copper alloy the competition analysis will focus on this product.

Demand-side substitution

34. 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.
35. 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.
36. 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.
37. Those firms that use extruded product to make components and other finished goods cannot substitute brass or copper alloy for another product. This is due to the different technical aspects of the various metals and their applications.
38. Manufacturers can by pass the forged product and import components for further processing or import the whole product finished. The degree to which the finished product is substitutable is subject to relative costs and product availability.
39. The substitutability of finished products will vary greatly between uses and customers. In some cases, manufacturers may be easily able to purchase components and products "off the shelf" while in other cases the extruded product might be necessary in order to fashion end products to specifications and to meet compatibility requirements. Relative costs will include consideration of how much re-engineering is required in order to switch from secondary manufacture to using the finished product.

Supply-side substitution

40. 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.
41. Supply side substitution for the extrusion of brass and copper alloy is low. Extrusion equipment is expensive and specific technical expertise is needed to produce different

forms of metal. It is not viable for producers of other metals, such as stainless steel, to enter the market for extrusion of brass or copper due to technical differences between the metals.

42. Supply side substitution for the import of brass and copper alloy, however, is possible. Firms importing one type of metal, for example steel, can possibly add brass and copper alloy to their lines by using the same import channels, storage facilities, transport arrangements, and distribution channels. These firms can be considered near entrants into the brass and copper alloy market via their potential to import.

43. The Commission is aware of a number of firms already evaluating plans to either begin importing into the New Zealand market and/or to add to the level and range of products they currently import.

Undifferentiated/Differentiated Products

44. 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.

45. 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.

46. Extrusions are an industrial commodity traded worldwide. There is no relevant product differentiation and apart from a few speciality architectural sections (of minor volumes), quality is similar throughout the world.

47. The Commission defines the functional level as the supply of brass and copper alloy extrusion.

Geographic Extent

48. 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.

49. 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.

50. 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.

51. 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.

52. 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.

53. The Australian Competition and Consumer Commission (the ACCC) adopted a national market for brass, copper and copper alloy extruded products when assessing the competition law implications of the acquisition by Consolidated Extrusions of the business and assets of Extruded Metals in 1999 (ACCC Mergers Public Register – *Consolidated Extrusion; Extruded Metals*, 17 November 1999).

54. Product is generally imported and shipped to all parts of New Zealand. The cost of freight as a percentage of the total cost is small such that there are no regional sub markets within New Zealand. The Commission defines the New Zealand market for brass and copper alloy as a national market.

Functional Level

55. The production, distribution and sale of a product typically occurs 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.[3] 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.

56. There are currently two major sources of supply in New Zealand, that manufactured by MCK and that imported by Consolidated Extrusions. Customers use extrusions from these sources interchangeably.

57. Therefore, the Commission concludes that the functional level affected by this acquisition is the supply of product covering both manufacture and import level.

---

[3] *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.”

Conclusion on Market Definition

58. The Commission concludes that the relevant market is the market in New Zealand for the supply of brass and copper alloy extrusion.

COMPETITION ANALYSIS

Substantially Lessening Competition

59. 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.

60. 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.[4] 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.[5]

61. Section 3(2) provides that references to the lessening of competition include references to the hindering or preventing of competition.[6]

62. 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
- whether the contemplated lessening is substantial.[7]

63. 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).

---

[4] *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).

[5] *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.

[6] For a discussion of the definition see *Commerce Commission v Port Nelson Ltd*, supra n 6, 434.

[7] 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.

64. 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.

65. 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

66. The Commission uses 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.

67. There is no evidence of other potential purchasers of the MCK plant should Consolidated Extrusions not purchase it. [

]

68. The Commission concludes that, if the acquisition does not proceed, MCK is likely to cease the production of brass and copper alloy from its New Plymouth plant. The Commission therefore proposes to use the exit of MCK from the market as the counterfactual.

Potential Sources of Market Power

69. 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.[8] 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.

---

[8] 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.

70. As previously noted, the extruded brass and copper alloy is largely an undifferentiated product where buyers make their purchases largely on the basis of price.

71. Consequently, the Commission has focused on the extent to which rivals can expand their supply to constrain any output restriction and raising of price by the merged entity.

Competition Analysis Principles

72. 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 the acquisition. In the present case the counterfactual is considered to be MCK exiting the market. 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.

73. 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 New Zealand market for brass and copper alloy under the following headings:

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

ANALYSIS OF EXISTING COMPETITION

Introduction

74. 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 subject of the analysis in this section.

Scope for Unilateral Market Power

Introduction

75. 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.

76. 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.[9]

77. 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.

THE NEW ZEALAND MARKET FOR BRASS AND COPPER ALLOY

Existing Participants

78. Competing providers of brass and copper alloy in New Zealand include:

- importers and;
- manufacturers.

79. The majority of brass and copper alloy in New Zealand is currently supplied by MCK (the only domestic producer of brass and copper alloy in New Zealand) and Consolidated Extrusions, which imports its product from Australia and distributes through Mico Wakefield. Imports are also sourced from Australia, South Africa, Korea, and China through companies such as Commercial Distributors (Auckland) and Green's Industries (Hamilton).

80. Copper and brass are also imported in the form of finished products such as taps, plumbing ware, and electrical fittings. While not in the same market, these do serve as a constraint on the extrusion and forging companies, therefore acting as a constraint on the suppliers of alloys. That is, when the price of alloy is too high there is an incentive for firms to purchase imported product, lowering the demand for brass extrusions, and ultimately alloys. Due to the diverse nature of these products it is difficult to measure the level of their import.

Inter-firm Relationships

81. Companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint to one another. Other less formal relationships between companies may also give rise to limitations on the extent of rivalry between them. Relationships between persons in the relevant market and other businesses may also affect rivalry in a market.

---

[9] 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 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.

82. Many of the participants in this market are interconnected or associated because they are owned by Consolidated Extrusions, or have marketing/supply agreements with them. Therefore, it is reasonable to aggregate their market presence in the competition analysis.

83. [ ]

Imports

84. In markets where imports are present, the Commission will consider whether actual competition from imported products is the equivalent to that from domestic supply. In undertaking this evaluation, the Commission will take into account the existence of any limits on quantities of imported product (the price elasticity of supply), and the effects on trade of various factors. Imports channelled through the parties to an acquisition, or persons associated with them, will be added to their domestic production in assessing market share, rather than being treated as independent sources of supply.

85. As previously noted, imports are a significant feature of the New Zealand market. Potential imports may also provide a constraint on domestic suppliers. This is considered as part of the assessment of the constraint from market entry below.

Safe Harbours

86. 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%.

87. 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

88. On the basis of the preceding discussion, the Commission proposes to use tonnes of brass and copper alloy as its primary measure of market share and concentration.

Table One: Market Shares in the New Zealand Brass and Copper Alloy Market

	Existing			Post-acquisition	
(Tonnes per annum)	**Conex/ Mico (Imports)**	**MCK/ Fraser**	**Imports (Independent)**	**Conex/ Mico/Fraser**	**Imports**
General Domestic					
Fraser Auckland					
Fraser Christchurch					
TOTAL					
GRAND TOTAL					
SHARE (%)					

89. With a market share of [ ] the proposed acquisition will breach safe harbours.

90. For the purpose of competition analysis the Commission has aggregated the market shares post acquisition. However, the Commission expects that the post acquisition market share of the merged entity would be eroded over time due to increased import competition and the likelihood of new entry from importers. Because it is difficult to predict exactly how much market share might be eroded, the Commission will use the combined market share of the two entities for the purpose of analysis.

91. 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

92. Market participants report that the market for brass and copper alloy is currently reasonably competitive with MCK providing good competition to Consolidated Extrusions, the largest player in the market. The fact that independently sourced raw material makes up only a small portion of the market is said to reflect a general satisfaction with the two players.

93. [

]

94. Imports other than those supplied by Consolidated Extrusions currently comprise a small portion of the market. Market participants note that imports are cost competitive and of comparable quality to the New Zealand made product. Longer lead times and the relative ease of sourcing from MCK or Consolidated Extrusions are attributed to the current low volume being imported.

95. Post transaction it is expected that Consolidated Extrusions will gain most of MCK's customers. The customer base is, after all, what Consolidated Extrusions is buying. However, some loss of customers is likely as customers seek new import opportunities to by-pass the merged entity.

96. Under the counterfactual, the situation may not be that different. As the major remaining supplier, Consolidated Extrusions would stand to gain from MCK ceasing production. However, the Commission has assumed that the degree of switch to other suppliers (importers) would be greater under the counterfactual than with the proposed transaction (otherwise Consolidated Extrusions would have no incentive to purchase MCK).

Conclusions – Unilateral Market Power

97. Consolidated Extrusions will potentially gain unilateral market power in the New Zealand market for brass and copper alloy extrusions by obtaining MCK, as reflected by its anticipated growth in market share. However, the Commission notes that Consolidated Extrusions market share will also increase under the counterfactual, though not as much as with the proposed transaction.

Scope for the Exercise of Coordinated Market Power

Introduction

98. 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.

99. 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).

100. 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

101. "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.

102. 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 New Zealand brass and copper alloy 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 Brass and Copper Alloy Market

Factors conducive to collusion	Presence of factors in the market
High seller concentration	Yes – individual market shares are high, but imports are widely available.
Undifferentiated product	Yes –commodity product readily available world wide
New entry slow	No – new entry from imports is readily available
Lack of fringe competitors	No – constraint from potential imports
Price inelastic demand curve	No – commodity product readily available world wide; customers will switch to importing finished components if they risk being priced out of the market.
Industry's poor competition record	No
Presence of excess capacity	Yes – excess capacity world wide due to declining market.
Presence of industry associations/fora	No

103. The assessment of the relevant structural and behavioural conditions in the New Zealand market for brass and copper alloy in Table 2 suggests that the market is not particularly likely to be susceptible to collusion, even after the acquisition.

Conclusions – Co-ordinated Market Power

104. It appears unlikely that the proposed acquisition would materially enhance the likelihood of co-ordinated market power in the New Zealand market for copper and brass alloy.

Conclusions – Existing Competition

105. The Commission considers that the scope for the exercise of co-ordinated market power would not be enhanced by the acquisition.

CONSTRAINTS FROM MARKET ENTRY

Introduction

106. 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.

107. 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.

108. 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

109. 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.

110. 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.

111. 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.

112. 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.

113. As already noted, the New Zealand market for brass and copper alloy extrusions is in decline. Furthermore, there is excess capacity in the Australasian market, volumes in New Zealand are small relative to world demand, and extrusion equipment is expensive. In light of these conditions, entry by a new domestic New Zealand brass and copper alloy extruder is unlikely.

114. There is, however, evidence of increasing opportunities for imports of both the extruded alloy and finished goods/components. Barriers to importing alloy and/or finished product are considered low. To establish as an importer of alloy requires

capital of around $250,000 for stock, overseas contacts, and a facility to store the product in New Zealand. There are opportunities for importers/distributors to enter the market, purchase in bulk, and supply other parties with small demands cost effectively.

115. Firms that have previously purchased alloy domestically will require additional capital to purchase and hold larger volumes of stock. Larger volumes of stock will be necessary to import cost effectively and to cope with longer lead times. Most firms spoken to noted that this will cost between $50,000 and $250,000 to carry this stock. Some have noted that this would be offset from cost savings of cheaper imported alloy.

116. There is evidence of firms importing small volumes of stock on a case-by-case basis. [

] Importers report low barriers to entry for importing product, noting that having a large customer would help establish a foot hold in the market.

The "LET" Test

117. 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

118. 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.

119. 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.

120. The Commission is aware of a number of market participants that have outlined plans to begin importing brass and copper alloy into the New Zealand market in the short to medium term. These plans include a number of firms already planning to import their own requirements such as [

]

121. Industry participants expect that the acquisition will create opportunities for a new importer/distributor of brass and copper alloy to set up in either Australia or New Zealand.

122. The Commission is aware of an independent importer/distributor of brass and copper alloy already operating in New Zealand. Commercial Distributors Limited was established in October 2001 by Kevin Shandley, an ex employee of MCK and Consolidated Extrusions. It sources from Australia and South Africa. [ ]

123. [ ]

124. [ ]

Extent of Entry

125. 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.

126. 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.

127. The number of market participants that have outlined plans to enter the New Zealand brass and copper alloy market and the volumes they are capable of importing suggests that the extent of entry into the short to medium term is likely to be significant

128. [ ]

129. Firms such as [ ] which uses large volumes of brass and alloy extrusion has outlined plans to import their product directly rather than go through the merged entity. [ ]

130. [ ]

131. [ ]

132. [ ]

133. Currently identified potential for new imports into the market suggests that between 10 to 20% of the market currently sourcing domestically will begin to import its product directly within twelve months of the propose acquisition proceeding.

Timeliness of Entry

134. 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.

135. 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.

136. Given the necessary incentive, new entry can take place quickly. The lead time for the supply of brass rods from imports if ordered from and Asian supplier (for example, Korea) is 9 weeks ex works plus 21 days shipping. From Europe it is 8 weeks plus 35 days shipping. [ ]. Industry participants are well aware of options for supply and can access new supply channels relatively quickly if they need to.

137. The Commission has identified a number of parties that have advanced plans to enter the market as an importer/distributor of brass and copper alloy. These participants could be up and running within three months. For a new firm to establish itself as an importer/distributor sources would need to be sought, storage arranged, and a reasonable customer based developed. Industry participants estimate this would take between 6 and 12 months.

Conclusion on Constraints from Market Entry

138. The Commission concludes that the barriers to entry are low for the import of brass and copper alloy into the New Zealand market and that entry by new importers is likely to be on a scale and sufficiently timely to offset the unilateral market power potentially gained by the transaction.

OTHER COMPETITION FACTORS

Constraint from Buyers or Suppliers

139. 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.

140. 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.

141. Brass and copper alloy experience competitive pressure from imports of ready made components and finished goods. There is a strong awareness of this both from the suppliers of alloy and those who manufacture the finished goods in New Zealand. [ ]

142. Countervailing power in this industry appears to be moderate to weak. Large customers do not seem to have significant power when it comes to price negotiation and leverage. This is not expected to alter in any way should the acquisition proceed.

OVERALL CONCLUSION

143. The Commission has considered the probable nature and extent of competition that would exist in the New Zealand market for the supply of brass and copper alloy. The Commission considers that the appropriate benchmark for comparison is MCK exiting the market regardless of the acquisition proceeding.

144. 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.

145. 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 – at current levels this may not constrain the merged entity, however, this is not that different from the counterfactual;
- potential competition from entry and importers will constrain the merged entity; and
- other competition factors, such as constraints from other parts of the supply chain.

146. 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 New Zealand market for the supply brass and copper alloy extrusion.

DETERMINATION ON NOTICE OF CLEARANCE

147. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the.

Dated this 14th day of August 2002

John Belgrave

Chair