

Statement of Preliminary Issues

Fletcher Building / Waikato Aggregates

4 December 2018

Introduction

1. On 29 November 2018, the Commerce Commission registered an application (the Application) from Fletcher Building Limited (Fletcher) seeking clearance to acquire all the assets and employees of Waikato Aggregates Limited (WAL), including the right to extract and process sand from the Tamahere quarry (Proposed Acquisition). However, WAL will maintain ownership of the underlying land of the quarry.¹
2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.²
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **Tuesday 18 December 2018**.

The parties

5. Fletcher is a limited liability company listed on the New Zealand Stock Exchange and the Australian Securities Exchange. Fletcher operates in various segments of the construction industry and its business can be segmented into building products, laminates and panels, plasterboard, steel, concrete, residential and development, and construction.
6. WAL is a privately owned company which owns and operates a sand quarry at Tamahere, located just south of Hamilton. The Tamahere quarry produces and processes sand, along with a small amount of other aggregates e.g. pebbles and stones.
7. WAL is a supplier of sand in the Waikato and Bay of Plenty (BOP) regions, while Fletcher also produces sand in the region and is a downstream customer of sand as an input into the supply of ready-mix concrete, concrete blocks, and concrete pipes.

¹ A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

² The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

The Proposed Acquisition is predominantly a vertical merger, although because Fletcher also produces sand in the region there is potentially also horizontal overlap.

Our framework

8. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.³ As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
9. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the Proposed Acquisition might lessen competition.⁴ If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
 - 9.1 constraint from existing rivals – the extent to which current rivals compete and the degree to which they would expand their sales if prices increased;
 - 9.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 9.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

Market definition

10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.⁵
11. The Applicant submitted that the relevant markets for assessing the Proposed Acquisition are:
 - 11.1 the upstream extraction and wholesale supply of sand in Waikato and BOP;
 - 11.2 the downstream wholesale and retail supply of ready-mix concrete in Waikato and BOP;
 - 11.3 the downstream supply of concrete masonry products (concrete blocks and pavers) in Auckland, Waikato, and BOP; and
 - 11.4 the downstream supply of pipes and pipe systems in New Zealand.

³ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

⁴ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁵ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

12. WAL is active upstream in the supply of sand, while Fletcher's main activities in the region are in the downstream markets. Understanding the scope of the relevant markets will be particularly important to our analysis of the vertical effects of the merger, as it will help to understand whether either of the merging parties has market power in the upstream or downstream markets.

Upstream extraction and wholesale supply of sand

13. The Applicant submitted that all types of sand are in the same product market because suppliers have the ability to switch between producing different types of sand, such as pit sand and concrete sand. It further submitted that the appropriate geographic dimension of the market comprises at least all quarries that currently supply the Waikato and BOP regions.
14. We will test whether this market definition is appropriate. In particular, we will test the:
- 14.1 ability of sand customers to use all types of sand interchangeably;
 - 14.2 ability of customers to substitute concrete aggregates for sand;
 - 14.3 ability of sand suppliers to switch between supplying different types of sand; and
 - 14.4 geographic dimension of the sand market, including whether the availability of backhaul transportation (ie, reducing the cost of transport by filling a truck on the return trip with a different load) may expand the scope of the geographic market.

Downstream wholesale and retail supply of ready-mix concrete

15. The Applicant submitted that the relevant market is for the manufacture and supply of ready-mix concrete and that the geographic scope of the market is at least 80km from the relevant manufacturing plant.⁶
16. We will test whether this market definition is appropriate. In particular, we will test the geographic dimension of the ready-mix market, focussing especially on the distance that ready-mix concrete can be economically transported.

Downstream supply of concrete masonry products (concrete blocks and pavers)

17. The Applicant submitted that precise definition of the market can be left open given that competition concerns are not likely to arise in any plausible market definition, but noted that the appropriate geographic scope of the market is Auckland, Waikato, and BOP.
18. We will consider what the appropriate market definition is. In particular, we will test the:

⁶ However, the Applicant noted that it is not necessary to come to a concluded view on this point for the purposes of assessing the competition effects of the Proposed Acquisition.

- 18.1 ability of suppliers to switch between manufacturing concrete blocks and pavers; and
- 18.2 geographic dimension of the market, focussing especially on the distance concrete blocks and pavers can be economically transported.

Downstream pipes and pipe systems

- 19. The Applicant submitted that there are separate relevant markets for small,⁷ medium⁸ and large pipes,⁹ which includes plastic and concrete pipes. It also noted separate markets for the wholesale and distribution of pipes.
- 20. We will test whether this market definition is appropriate.

Without the acquisition

- 21. We will consider what the parties would do if the Proposed Acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding an alternative buyer.

Preliminary issues

- 22. The questions that we will be focusing on when assessing whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant markets are:
 - 22.1 horizontal unilateral effects: would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?
 - 22.2 vertical effects: would the merged entity be able to engage in behaviour that forecloses rivals and renders them less able to compete?
 - 22.3 conglomerate effects: would the merged entity be able to engage in tying or bundling behaviour of sand, aggregates, and/or cement to foreclose rivals and render them less able to compete?
 - 22.4 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that coordination is more likely, more complete, or more sustainable?

Horizontal unilateral effects: would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?

- 23. Where two suppliers compete in the same market, a merger of the two would remove a competitor that would otherwise act as a competitive constraint,

⁷ Pipe diameter under 250mm.

⁸ Pipe diameter between 250mm and 450mm.

⁹ Pipe diameter over 450mm.

potentially allowing the merged entity to raise prices or lessen quality.¹⁰ A merger could also reduce competition if one of the merging firms was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm.

24. The Applicant submitted that the Proposed Acquisition will not give rise to unilateral effects because it does not compete with WAL to supply sand in any relevant market. Although the Applicant produces concrete sand at its Pukekawa quarry, in North-West Waikato, it submitted that it does not supply concrete sand to third party concrete manufacturers from Pukekawa.
25. We will assess the degree of constraint that Fletcher and WAL currently impose upon one another for the supply of sand, and the extent to which that constraint may increase without the Proposed Acquisition. To the extent that any constraint is material, we will assess whether the lost competition between the merging parties could be replaced by existing and/or potential competitors.

Vertical effects: would the merged entity be able to engage in behaviour that forecloses rivals and renders them less able to compete?

26. A key focus of the investigation will be whether the Proposed Acquisition raises vertical concerns. A vertical merger is a merger between firms operating at different levels of a supply chain (for example, a wholesaler and a retailer). Vertical mergers can provide merged entities the ability and incentive to foreclose downstream rivals, including by raising the costs of rivals or by changing the conditions of entry to make it harder to enter or expand.
27. The Proposed Acquisition between Fletcher and WAL would combine two firms that provide services at different levels of the supply chain. As we noted above, WAL is active in the upstream market for the supply of sand, while Fletcher's main activities in the region are in the downstream markets. We will assess whether the Proposed Acquisition might create the ability and incentive to foreclose rivals. We will consider whether the merged entity would seek to foreclose downstream rivals in the supply of:
 - 27.1 ready-mix concrete;
 - 27.2 concrete masonry products (ie, concrete blocks and pavers); and/or
 - 27.3 pipes and pipe systems.
28. The merged entity could attempt to foreclose downstream rivals in these markets by refusing to supply them sand or by increasing the price it charges to these rivals. This may allow the merged entity to capture more downstream sales which may also allow it to raise the downstream prices or reduce the quality of its service.

¹⁰ For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

29. The Applicant submitted that the Proposed Acquisition does not raise any vertical concerns because downstream rivals have alternative sources of sand supply. The Applicant argues that downstream rivals could get sand from other suppliers in the Waikato and BOP regions if the merged entity refused to supply it or increased the price of the sand. Therefore, it would not be in the interests of the merged entity to engage in a foreclosure strategy because any profits gained in the supply of downstream concrete products would not exceed the lost profits from reduced sand sales.
30. As part of our assessment of the vertical effects of the merger, we will consider:¹¹
- 30.1 whether the merged entity would have the ability to foreclose, through having control over an important sand input;
 - 30.2 whether the merged entity would have the incentive to foreclose, through earning additional profit from the strategy that outweighs the costs of lost sand sales; and
 - 30.3 whether the competition lost from any foreclosed competitors would be sufficient to have the likely effect of substantially lessening competition.

Conglomerate effects: would the merged entity be able to engage in tying or bundling behaviour of sand, aggregates, and/or cement to foreclose rivals and render them less able to compete?

31. A conglomerate merger is a merger between firms supplying different goods or services to the same set of customers. A conglomerate merger could enable the merged entity to hinder rivals' ability to compete by:
- 31.1 providing bundled discounts to customers that buy the merging parties' products together rather than separately; or
 - 31.2 tying, where the merged entity refuses to sell one of the merging parties' products (usually a "must have" product) unless customers also buy the other parties' product/s.
32. Such bundling or tying could foreclose rivals through their inability to offer products comparable to the tied or bundled products and ultimately reduce competition.
33. Fletcher is also a supplier of concrete aggregates and cement in New Zealand. These products are also used in the production of ready-mix concrete, concrete masonry products, and concrete pipes, and are therefore sold along with sand to downstream customers. This creates the potential for the merger to cause conglomerate effects. This could result in a significant lessening of competition if it foreclosed rivals from certain markets or denied rivals from reaching sufficient scale to provide effective competition.

¹¹ Merger Guidelines at 46.

34. The Applicant submits that it is unaware of any quarries offering bundles or linked discounts in the Waikato and BOP regions.
35. As part of our assessment of the conglomerate effects of the merger, we will consider:
 - 35.1 whether the merged entity would have the ability to foreclose, through having market power for at least one product sold to downstream customers;
 - 35.2 whether the merged entity would have the incentive to foreclose, through earning additional profit from the strategy; and
 - 35.3 whether the competition lost from the foreclosed competitors is sufficient to have the likely effect of substantially lessening competition.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

36. We will assess whether the Proposed Acquisition would make coordination more likely, more complete or more sustainable. As part of our assessment we will consider whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets.
37. In particular, we will assess whether the Proposed Acquisition will make it easier for the merged entity to monitor and punish the behaviour of downstream or upstream rivals and hence make coordination more likely.

Next steps in our investigation

38. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **18 February 2019**. However, this date may change as our investigation progresses.¹² In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.
39. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

40. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Fletcher/WAL" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **Tuesday 18 December 2018**.
41. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

¹² The Commission maintains a case register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

42. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.