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Decision No. 412

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

James Hardie New Zealand Limited

and

Long International Limited

The Commission:	M J Belgrave M N Berry E C A Harrison
Summary of Proposed Acquisition:	The acquisition by James Hardie New Zealand Limited of the assets of Long International Limited.
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:	15 December 2000

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THE PROPOSAL

1. On 24 November 2000, the Commission registered a notice pursuant to section 66(1) of the Commerce Act 1986 (the Act), in which clearance was sought by James Hardie New Zealand Ltd (James Hardie) to acquire all the assets of Long International Ltd (Long International). The assets include plant and equipment, inventory, vehicles and a lease of premises.

THE PROCEDURES

2. The notice was received and registered on 24 November 2000. 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 the notice agree to a longer period. The Commission has agreed with James Hardie that the matter shall be decided in 15 working days. Accordingly, a decision is required by 15 December 2000.
3. The Commission's decision is based on an investigation conducted by staff. In the course of the investigation Commission staff obtained information from a number of industry parties. These included:
 - Glenroy Insulated Products Ltd;
 - Lanwood Industries Ltd;
 - Insulation Panel and Door Ltd;
 - Long International Ltd;
 - Long Plastics New Zealand Ltd;
 - Arrow International Ltd;
 - Portacom New Zealand Ltd; and
 - Koolfoam Industries Ltd;
4. Commission staff also obtained additional information, to that provided in its application for clearance, from James Hardie.
5. James Hardie sought a Confidentiality Order in terms section 100 of the Act in respect of certain information in the application. Such an Order was made on 30 November 2000.

THE PARTIES

James Hardie New Zealand Ltd

6. James Hardie's ultimate parent is James Hardie Industries Ltd which is registered in Australia. The most important area of the operations of the James Hardie Group, previously in Australia, is now in the United States and the New Zealand company's immediate parents are two United States based-investment companies owned by the James Hardie Group. James Hardie Industries Ltd also has a presence in the Philippines. The New Zealand-based James Hardie has no subsidiaries.
7. James Hardie has two operating divisions. One, James Hardie Building Products is a manufacturer of fibre cement building products. Such products

are predominantly used for exterior architectural cladding of commercial and industrial buildings, and domestic residences.

8. The other division, James Hardie Building Systems manufactures and sells polystyrene blocks and sheets, polystyrene based architectural claddings and polystyrene insulated panels for use in temperature controlled buildings. James Hardie produces its own polystyrene to use in the manufacture of the latter two products. It also arranges the site erection of the panels it produces.
9. James Hardie has manufacturing facilities in both Auckland and Christchurch. However, James Hardie does not manufacture its fibre cement products in Christchurch.

Long International Ltd

10. Long International is owned by Arcus Holdings Ltd which is a private company owned by two individuals. Arcus Holdings Ltd's other subsidiaries are:
 - Arrow International Ltd which is a company which provides project and construction management services¹;
 - Taylor Equipment Ltd²; and
 - Long Plastics New Zealand Ltd (Long Plastics)³.
11. Long International's operations are similar, but not identical, to those of James Hardie's building systems division:
 - Long International has manufacturing facilities only in Belfast, Christchurch;
 - Long International manufactures polystyrene blocks and sheets. However, rather than selling to any buyer in the market, as does James Hardie, Long Plastics has an exclusive right to purchase polystyrene blocks and sheets from Long International for processing and sale, either in block, sheet or other forms to buyers in the market;
 - Long International also manufactures polystyrene based architectural cladding and insulating panels in its Christchurch factory but, unlike James Hardie, a major part of Long International's business is the provision of design, manufacture and build services for purchasers of temperature controlled and other buildings for which polystyrene based insulated panels are the most economic application. For example, the recently constructed \$[] million cold store at the Port of Wellington store was designed and built by Long International. Of the \$[] million total cost, Long International provided insulated panels at a cost of \$[]

¹ In the same manner as for example Fletcher Construction and Mainzeal.

² Taylor Equipment Ltd is an importer of fast food making equipment.

³ Long Plastics is not wholly owned by Arcus Holdings. Long Plastic's Chief Executive also owns one third of the company.

million. Long International estimates that of its \$[] million annual turnover, two thirds is the manufacture of polystyrene, architectural and insulating panels and erection on site and one third is the provision of design, manufacture and build services. This latter part of the business is not part of the assets proposed to be sold to James Hardie.

12. The assets of Long International which James Hardie proposes to purchase have a book value of \$[] million. The purchase price of these assets is still under negotiation but James Hardie states the final price will be between \$[] and [] million. The assets comprise:

- an insulated panel laminating machine;
- a polystyrene block moulding machine;
- polystyrene block cutters;
- boilers and compressors
- stock comprising rolls of sheet steel, polystyrene beads, expanded polystyrene and manufactured insulating panel;
- the lease of Long International's site; and
- other material such as tools, office equipment and vehicles.

13. [

]

Long Plastics New Zealand Ltd

14. Long Plastics is a manufacturer of polystyrene products. One third of its business involves the purchase of polystyrene blocks from Long International and:

- profile cutting the blocks into a myriad of shapes of which packaging for domestic appliances, signage, artificial columns for decorative purposes and fascias for windows are a few examples; and
- cutting the blocks into sheets of polystyrene insulation for sale to building merchants and the building industry generally.

15. Long Plastics purchase polystyrene blocks only from Long International. The two sister companies have an agreement that Long International will not market polystyrene products, other than insulated panels and architectural claddings. Long Plastics, therefore, is a competitor with James Hardie in polystyrene markets in the South Island.

16. Arcus Holdings does not currently intend to sell Long Plastics.

Lanwood Industries Ltd and International Panel and Door Ltd

17. Lanwood Industries Ltd (Lanwood) and International Panel and Door Ltd (IPDL) are private companies which manufacture and sell polystyrene blocks, polystyrene based architectural claddings and insulated panels. []]. Both utilise the polystyrene they produce for the manufacture of the latter two products. Both are located in Palmerston North.
18. Lanwood is a long established company and IPDL entered the market four years ago.

DESCRIPTION OF THE POLYSTYRENE AND POLYSTYRENE PRODUCTS INDUSTRY

Manufacture of Expanded Polystyrene

19. The raw material used for the manufacture of expanded polystyrene is imported into New Zealand as grains approximately the size of common domestic sugar. Expansion of the grains into polystyrene beads of various sizes and densities, by the addition of heat, occurs at several manufacturing plants throughout New Zealand. Expanded polystyrene has a low value per unit of volume (its volume is mostly air). The raw material, in grain form, as imported, has a much higher density than expanded polystyrene and this reduces transport costs per unit volume of finished product. No expanded polystyrene products are imported into New Zealand, other than as packaging for products manufactured overseas.
20. Subsequent addition of more heat and pressure to the previously expanded polystyrene beads, within moulds in block and profile moulding machines, allows the production of respectively, large blocks of polystyrene and polystyrene shapes for various applications.
21. Polystyrene blocks produced in New Zealand may be up to 5 metres in length and up to 1.6 metres by 1.2 metres in cross-section. They have the following applications:
- unprocessed, as ground fill to roads, car parks and bridge approaches;
 - when cut into sheets⁴, for the insulation of commercial buildings and residential houses;
 - when cut into sheets and plastered with a hard, weather resistant coating, as exterior cladding of commercial buildings and residential houses;
 - as raw material for polystyrene products such as packaging for domestic appliances, signage, fish, flower and vegetable boxes in which such

⁴ By the block manufacturers and other downstream polystyrene processors.

products are delivered to their wholesale purchasers. These uses are not relevant to the Commission's consideration of the application for clearance as neither James Hardie nor Long International carries out the profile cutting or injection moulding process necessary to manufacture these types of polystyrene products; and

- when laminated on both sides with steel sheet of various profiles, for use as insulated panels in controlled temperature buildings and for architectural cladding of buildings.
22. Polystyrene blocks and sheets are produced by James Hardie in Auckland and Christchurch; Long Plastics Auckland Ltd Koolfoam Industries Ltd and Expol Ltd in Auckland, Lanwood and IPDL in Palmerston North, Glenroy Insulated Products Ltd in Blenheim (Glenroy) and Long International in Christchurch. Long Plastics Auckland Ltd is not owned by Arcus Holdings Ltd [
-]. These companies cut polystyrene blocks into sheets of varying size and thickness.
23. While polystyrene is produced in different grades of hardness, there is no technical difference between the polystyrene produced by any New Zealand manufacturers which would give any of them a competitive advantage.

Insulating Wall Panels and Roofs for Controlled Temperature Buildings

24. Polystyrene sheets when laminated on both sides with steel sheet of various profiles find use in the construction of controlled temperature buildings. The insulated panels are suitable for this application because of their insulating properties, their high strength to weight ratio and their relatively low cost.
25. These insulated panels may be of various thicknesses depending on the temperature difference against which the panels are required to insulate and the strength required from the panels as load bearing walls of controlled temperature buildings. Freezer panels may be 250 millimetres thick while cool store panels may be only 100 millimetres thick. The insulated panels may be of varying widths up to the maximum width of the polystyrene block from which the panels are produced (1.6 m). The maximum length of insulated panels is determined only by considerations regarding transport to the construction sites..
26. The insulated panels are manufactured in a continuous process machine whereby polystyrene sheets, cut to a thickness appropriate to the intended application from the polystyrene blocks, are sandwiched between two sheets of steel which are continuously glued to the polystyrene sheets as they pass through the machine.
27. There are six insulated panel machines operating in New Zealand in conjunction with polystyrene block moulders. The machines are owned by James Hardie in Auckland and Christchurch, Lanwood and IPDL in Palmerston North, Glenroy Insulated Products Ltd (Glenroy) in Blenheim and Long International in Christchurch.

28. With the exception of the insulated panels manufactured by Glenroy⁵, only minor differences exist in respect of the size and shape of the panels, the profiles of the steel laminations and in the jointing arrangements between individual panels manufactured by all the companies named in paragraph 27. All insulated panels are closely similar and, Glenroy's situation aside, no one company has a technical advantage over the others.

Polystyrene Based Architectural Cladding

29. Polystyrene sheets of varying thicknesses, laminated with steel sheet of various profiles on both sides, are finding increasing use as an architectural cladding for commercial buildings. This application, independent of polystyrene panels' traditional roles as insulating walls and roofs, relies on the panels weather resistance, light weight per square foot panel and, in some circumstances cost advantage, and competes with other more traditional exterior claddings of buildings.
30. Whilst it is manufactured in the same process, polystyrene architectural cladding differs from insulated wall panel in that architectural cladding is commonly of a lesser thickness and is often coloured.⁶
31. The companies listed in paragraph 27 also manufacture polystyrene based architectural cladding. There is a difference between the architectural cladding which Long International manufactures and that of the other manufacturers. The design of Long International's panel machine allows it to produce architectural cladding with substantial corrugations allowing its product, uniquely, to be used for "architectural" type roofing⁷. Otherwise, architectural cladding produced by the companies listed in paragraph 27 is closely similar and no one company has a technical advantage over the others.

MARKET DEFINITION

Introduction

32. The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered, and in which the application of section 47(1) of the Act can be examined.

33. Section 3(1A) of the Act provides that:

“...the term ‘market is a reference to a market in New Zealand for goods and services as well as other goods and services, that, as a matter of fact and commercial common sense, are substitutable for them.”

⁵ See paragraph 107.

⁶ Insulated wall panels for temperature controlled buildings appear to be uniformly manufactured with a cream colour.

⁷ Other architectural panel manufactures are able to produce a roof panel. However, in their cases this involves purchasing a steel roofing sheet from its manufacturer and gluing it to polystyrene panels in a manual, rather than machine operated process. This enormously adds to the costs of producing such panels.

34. Principles of market definition are contained in *Telecom Corporation of New Zealand Ltd v Commerce Commission*⁸, and in the Commission's *Business Acquisition Guidelines* ("the Guidelines"). These principles are outlined below.
35. Markets have three dimensions: product type, geographical extent and functional level. In some situations it is also necessary to allow for time, and to consider a temporal dimension. A market includes products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers or sellers are able to substitute other products, or the same product from other geographical regions, when there is an incentive to do so because of a change in relative prices of the relevant products. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. Within this space, a hypothetical, profit-maximising, monopoly supplier could exert market power, because buyers, facing a rise in price, would have no close substitutes to turn to.
36. A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the "ssnip" test), assuming that other terms of sale remain unchanged.
37. Markets are also defined by functional level. Typically, production, distribution and sale occurs through a series of stages, with markets intervening between suppliers at one vertical stage and buyers at the next.

Relevant Markets

Product Markets

38. James Hardie has submitted that the product markets which would be affected by the proposed acquisition are those for:
- polystyrene for use by both industrial/commercial and residential consumers – the expanded polystyrene or EPS market⁹;
 - insulated panels for use by both industrial/commercial and residential consumers – the insulated panel market; and

⁸ *Telecom Corporation of NZ Ltd v Commerce Commission* (1991) 4 TCLR 473, 502: 3 NZBLC 102,340, 102,362

⁹ James Hardie and the industry generally refer to the product as "expanded" polystyrene. This is to differentiate it from the sugar grain sized raw material described above. However, the Commission believes that, in common parlance, the term polystyrene has implied in it the adjective "expanded". Therefore, it has not used the technical description in this Decision.

- architectural cladding for use by both industrial/commercial and residential consumers– the architectural cladding market.

39. Each of these three proposed product markets is discussed below.

Polystyrene

40. The Commission considers that the polystyrene market is better described as that for the manufacture of polystyrene in block and sheet form and supply to:

- building merchants and builders of industrial, commercial and domestic residential buildings for exterior cladding and insulation purposes;
- civil engineering constructors for ground fill purposes in those applications where the load bearing capacity of the ground is low; and
- to those persons whose business is the profile cutting of polystyrene, as a raw material for cutting into many and varied shapes of which packaging for domestic appliances, decorative columns for buildings and houses, and signage are examples.

41. The Commission notes that while polystyrene is also produced as a raw material core for use in the manufacture of polystyrene-based insulated panels and architectural claddings, in every case such manufacturers produce their own polystyrene blocks, and in no case does a manufacturer of insulated panels and architectural cladding purchase polystyrene from elsewhere. The Commission concludes that in this respect the manufacture of polystyrene blocks forms part of markets concerned with architectural cladding and insulated panels.

42. The Commission has considered whether other products could be considered close enough substitutes to be included in the market as follows:

- pink batts are also used to insulate commercial, industrial and residential buildings. However the applications of pink batts and polystyrene are different. Pink batts are a preferred product in wall, roof and ceiling insulation applications because, unlike rigid polystyrene panels, they can be made to fit into the slightly varying spaces between the building support structural members without the need for cutting. Further, pink batts are not suitable for under-concrete floor insulation as they have no compressive strength;
- along with plastered polystyrene sheets, many other exterior building claddings are available¹⁰. However, polystyrene sheets when plastered with a waterproof, impact resisting coating are used by builders as an exterior cladding of commercial buildings and domestic residential housing for the dual purposes of weather resistant cladding combined with insulation. Of the many other products available for the exterior

¹⁰ For example, glass, fibre cement sheets, brick veneer, steel, timber, concrete slabs and concrete blocks.

claddings of buildings available no other exterior claddings fulfil this dual function; and

- road metal and more particularly pumice may be used as a substitute for ground fill applications. However, in those applications where the load bearing ability of the soil over which ground fill is to be laid is particularly low, polystyrene blocks are the specialist application.
43. It is axiomatic that there can be no products which substitute for polystyrene blocks as a raw material for the downstream processors of polystyrene into various packaging, signage and building products.
44. The Commission concludes that the above products are only likely to compete at the fringes of the market and that the polystyrene market is as described in paragraph 40.

Insulated Panels

45. The Commission considers this product market is better described as that for polystyrene insulated panels for the construction of controlled temperature commercial and industrial buildings. The Commission has found no examples of these panels being used for domestic residential purposes. In fact, industry sources have described their attempts to introduce insulated panels into the housing market as an abject failure.
46. Typical applications of insulated panels are for stand alone cold stores and cool rooms within supermarkets, freezers for the freezing and storage of primary produce, wineries for the low temperature storage of wine, facilities for the processing of meat of chicken products and controlled temperature warehouses.
47. Purchasers in this market are typically builders, civil engineering contractors, and construction companies.
48. James Hardie, in its application, proposed several substitutes for insulated panels. The Commission has considered whether these products could be considered close enough substitutes to be included in the market as follows:
- corrugated iron is believed to be the cheapest uninsulated construction material but as soon as insulation is required polystyrene insulated panels become the cheapest construction option. Similar observations may be made in respect of concrete, fibre cement and plywood constructions. The Commission does not consider concrete, corrugated iron, fibre cement or plywood to be in the insulated panel market;
 - laminated insulated panels have a further advantage over the above products in several food processing applications in that they easily meet food processing regulations because of the ease of wash down of the painted steel interior coatings of the insulated panels.

49. The Commission concludes that there does not appear to be any substitute for polystyrene insulated panel for controlled temperature buildings amongst the above products which are only likely to compete at the fringes of the market and that the insulated panel market is as described in paragraph 45.

Architectural Cladding

50. The Commission considers that this market may be described as that for exterior architectural cladding of industrial, commercial and domestic residential buildings. As stated, the Commission has found no examples of polystyrene insulated panels being used for domestic residential purposes, but notes that most of the other substitute products discussed in paragraph 9.13¹¹ of James Hardie's application are used in all three classes of building.
51. Architectural cladding does not necessarily form the support structure of a building, rather it is often attached to that structure¹². In this market, it is the impact and weather resistance of the polystyrene panels which are utilised rather than their insulating properties which are of secondary importance. Architectural cladding, made from polystyrene panels, is generally thinner than polystyrene insulated wall panels. Typically, architectural cladding has a maximum thickness of 100 millimetres whereas insulated panels for cold stores begin at that thickness.
52. Purchasers in this market are typically builders, civil engineering contractors, construction companies.
53. The Commission agrees with the suggestion in James Hardie's application that the various other types of architectural cladding are also part of this market. The substitutes are listed in table 9.13 of the application. Long International, for example, manufactures and installs architectural cladding on high rise apartment buildings, sports stadiums and retail stores. It stated that, while in some cases polystyrene-based architectural cladding was used for its aesthetics, lightness, ease of erection or low cost, in other cases glass, steel, wood or fibre cement products were preferred by architects and builders. Long International stated that in this market, orders flowed from competitive tenders and it had to be price competitive against other types of architectural cladding if it was to win tenders. The Commission considers polystyrene based laminated panels are substitutable with the other products referred to above.

Functional Market

54. The relevant functional markets are those for the manufacture and supply of polystyrene blocks, polystyrene insulated wall panels and polystyrene architectural cladding.

¹¹ For example, fibre cement products from various manufacturers, brick veneer, steel, timber, concrete slabs and blocks and coated polystyrene sheet.

¹² In comparison with insulated panel in a coldstore, for example, which are an integral part of the structure of the wall and roof of the coldstore.

Geographic Markets

55. James Hardie has submitted that the three relevant product markets are national in scope. It claims that the cost of transport does not prohibit manufacturers of polystyrene block, polystyrene insulated panels and architectural claddings from economically competing throughout New Zealand.

Polystyrene

56. James Hardie provided no evidence for its contention that the market for the manufacture and supply of polystyrene blocks and sheets is national in its scope, other than to state James Hardie and Long International have national distribution.
57. The Commission does not accept that this market is national. Comments made from industry sources contradict James Hardie's statement. In general, polystyrene in block or sheet form may be economically transported only within each of the North and South Islands. That the costs of transporting polystyrene block and sheets are very high relative to the value of the product is shown by the cost to transport polystyrene blocks or sheets from Lanwood in Palmerston North¹³ to Invercargill, of \$110 per cubic metre. The retail price of polystyrene block in Invercargill is about \$140 per cubic metre. Similarly, to transport polystyrene block or sheets from Lanwood in Palmerston North to Christchurch would cost \$95 per cubic metre. The retail price of polystyrene block in Christchurch is about \$120 per cubic metre.
58. This implies that a hypothetical monopoly supplier in Christchurch could potentially raise its prices by 90% in Invercargill and Christchurch while still having a cost advantage over North Island suppliers. This pricing discretion suggests the geographic extent of the market for the manufacture and supply of polystyrene block and sheets is that for each of the North and South Islands individually.
59. Industry sources confirmed this conclusion by stating to the Commission that the only pure polystyrene products which cross Cook Strait are the relatively high value injection moulded fish export boxes manufactured in Nelson. However, fish boxes and similar polystyrene packaging products are not in the markets defined by the Commission to consider this application.

Insulated Panels and Architectural Cladding

60. James Hardie provided some evidence for its contention that the markets for the manufacture and supply insulated panels and architectural cladding are national in its scope.
61. In respect of insulated panels, James Hardie provided tables¹⁴ in its application purporting to prove that IPDL, a Palmerston North based manufacturer was

¹³ Along with IPDL, the manufacturer of polystyrene block and sheet, physically closest to the South Island.

¹⁴ In paragraph 9.28 of its application.

actively competing in the South Island. Commission investigations have shown that the evidence provided is not entirely accurate. IPDL informed the Commission that only 5% of its output over the last four years of operation has been in the South Island and the reasons it obtained South Island work were unrelated to the delivered price of its insulated panel products. In particular, of the six projects James Hardie claimed IPDL had completed in the South Island two had been obtained as a result of the [

]. A third project at the NZ Winery in Blenheim was, unusually, carried out on the basis that the builder of the winery provided the freight and labour components of the contract. [

]. The remaining three projects which James Hardie claimed IPDL had carried out in the South Island¹⁵ had not been carried out by IPDL. The Commission does not consider this table provides firm evidence pointing towards the existence of a national market for insulated panels.

62. However, IDPL did state that it had carried out a project in Edendale, Southland, which no other company had tendered for. [IDPL said that in the case of that project freight costs were 20% of the total cost of the insulated panels it provided.
63. IDPL did not believe that the architectural cladding and insulated panel markets were national in scope. Rather in its view, there were separate North and South Island markets.
64. Lanwood Industries had the same view. It believes that the cost of freighting insulated panels and architectural cladding across Cook Strait adds at least 10% to the cost of those products and, given the competitive nature of the market, that extra cost makes its tendered prices uncompetitive in the South Island.
65. James Hardie provided a second table in its application¹⁶ purporting to prove that Long International was, from its Christchurch manufacturing plant, able to compete in Auckland and in Wellington. The Commission accepts that the information contained in that table is accurate. It notes that in the case of the Matakana Wines, Warehouse Mangere, North Harbour Tennis Centre, Oakwood Apartments and Mudbrick Estate projects the products supplied were in the architectural cladding market whilst the other three projects tabulated involved the supply of insulated panels.
66. IPDL stated it was not invited to tender for any of the projects listed in the second table of paragraph 9.28¹⁷ of the application.
67. In Lanwood Industries's view this table did not prove the existence of a national market. It claimed there were special features which had led to Long

¹⁵ That is, three small coolstores for Best and West, the Berry Barn Bakery for de Geest Builders and the Kaikoura Bakery.

¹⁶ Also as part of paragraph 9.28.

¹⁷ For example, Matakana Wines, Grey Lynn Foodtown, The Mangare Warehouse, North Harbour Tennis Centre, Port of Wellington cold store and Oakwood Apartments.

International obtaining the work outlined in the second table in paragraph 9.28 of the application. It also pointed out that these were only 8 projects out of many hundreds that had been carried out in recent years by the North Island insulated panel manufacturing companies. It also noted that it had successfully tendered for only two projects in the South Island, one of which was 15 years ago, despite having tendered for South Island projects about 30 times in recent years.

68. The Commission considers that in the vast majority of cases insulation panels are manufactured and supplied to projects only within the island of their manufacture. There are a very small number of cases where insulation panels have been delivered to site across Cook Strait and there are special circumstances to explain these cases. Normally shipping from the North Island to the South Island will add 10 – 20% to the erected cost of insulated panels. These figures will be slightly less for insulated panels moving from the South Island to the North Island because of the discounts which exist for freight moving in that direction. –The Commission considers this pricing discretion suggests the geographic extent of the market for the manufacture and supply of polystyrene insulated panels is that for each of the South and North Islands individually.
69. The higher value added in the manufacturing of polystyrene architectural cladding allows it to be competitively supplied from one Island to the other. The Commission has accepted that there are other products in the architectural cladding market and it notes that Monier, Dimond, Firth and Steel and Tube, all of whom supply the architectural cladding market, operate as national chains. Polystyrene architectural cladding with an erected value of [] per square metre has a much higher value to freight cost ratio than have insulated panels with an erected value of \$[] per square metre with similar freight costs. This allows architectural cladding to be economically transported further relative to insulated panels. Long International's success in winning architectural cladding work in the Auckland area using cladding manufactured in Christchurch supports this conclusion.
70. The Commission therefore agrees with James Hardie's suggestion and considers that architectural cladding is supplied in a New Zealand wide market.

Conclusion as to Relevant Markets

71. The Commission considers the following markets are relevant to its consideration of James Hardie's application:
- the North and South Island markets¹⁸ for the manufacture and supply of polystyrene block and sheet to:

¹⁸ In the remainder of this Decision the terms, North and South Island polystyrene markets, are as a shorthand description of these markets.

- building merchants and builders of industrial, commercial and domestic residential buildings for exterior cladding and insulation purposes;
- civil engineering constructors for ground fill purposes in those applications where the load bearing capacity of the ground is low; and
- to those persons whose business is the profile cutting of polystyrene, as a raw material for cutting into many and varied shapes of which packaging for domestic appliances, decorative columns for commercial buildings and domestic residential housing, and signage are examples,

and

- the North and South Island markets¹⁹ for the manufacturer and supply of polystyrene-based insulated panel for the construction of controlled temperature commercial and industrial buildings;

and

- the New Zealand market for the manufacture and supply of exterior architectural claddings for industrial, commercial and domestic residential buildings

COMPETITION ANALYSIS

Introduction

72. Competition analysis assesses competition in the relevant markets. in order to determine whether a proposed acquisition would result, or would be likely to result, in the acquisition or strengthening of dominance. Section 47 of the Commerce Act proscribes a person acquiring of assets of a business or shares where as a result:

(a) That person or another person would be, or would be likely to be, in a dominant position in a market: or

(b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened.

73. The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Read together, sections 66(3) and 47(1) require that, where the Commission is satisfied that a proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not so satisfied, clearance must be declined.

¹⁹ In the remainder of this Decision the terms, North and South Island insulated panel markets, are used as a shorthand description of these markets.

74. Judicial pronouncements set a high threshold for dominance. In his judgment in *Commerce Commission v Port Nelson Limited*²⁰, McGechan J included the following statements²¹:

'Dominance' includes a qualitative assessment of market power, It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a high degree of market *control*.

How high? Clearly, not absolute control. There need not be monopoly. There need not be an ability to act totally without regard to competitors, suppliers, or customers. ... (However), (t)he firm must be able to set terms of trading independently of significant market constraints. It must be able to set prices or conditions without significant constraint by competitor or consumer reaction (emphasis in original).

75. The Commission's *Business Acquisition Guidelines* also recognise that dominance involves a high degree of market power. The Guidelines reflect the idea that for a firm to be dominant it must have the power to behave in a manner different from that which a competitive market would allow. The *Guidelines* (paragraph 7) state that:

A person in a dominant position in a market will be able to set prices or conditions without significant constraint from competitor reaction.

A person in a dominant position will be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long run.

76. As the *Port Nelson* judgment highlighted²², the analysis of dominance must centre upon the provisions of section 3(8) of the Commerce Act. In relation to section 47, the relevant provisions are contained in section 3(9). The section requires that regard be had to three groups of factors:

(a) The share of the market, the technical knowledge, the access to materials or capital of that person or that person together with any interconnected body corporate:

(b) The extent to which that person is constrained by the conduct of competitors or potential competitors in that market:

(c) The extent to which that person is constrained by the conduct of suppliers or acquirers of goods or services in that market.

77. The weight that will attach to each of these considerations will vary from case to case. As Richardson P noted in *AMPS A*:²³

(Section 3(9)) does not allow any theoretical or intuitive ranking applicable in all cases. It proceeds on the premise that the weighting must vary according to the particular facts. It calls for a pragmatic assessment in the particular circumstances of one's ability to exercise a dominant influence in one or more aspects of the relevant market.

²⁰ (1995) 6 TCLR 406

²¹ *Ibid*, 441 – 42. This test was affirmed by the Court of Appeal in *Port Nelson Ltd v Commerce Commission* (1996) 3 NZLR 554, 573

²² *Ibid*, 442-443

²³ *Telecom Corporation of NZ Limited v Commerce Commission* (1991) 3 NZLR 429, 444

78. In relation to the present application, attention will be directed only at the two markets in which the Commission believes aggregation, the effect of which is more than minimal, will occur as a result of the proposed acquisition. The markets, where aggregation that has a more than minimal effect, are the South Island polystyrene market and the South Island insulated panel market.
79. In respect of the other relevant markets, there is no aggregation in either the North Island polystyrene market or the North Island insulated panel market as a result of the proposed acquisition. There is minor aggregation in the New Zealand market for architectural cladding. However, given that there are at least 12 competitors in the market, with no participant having more than 20% market share²⁴, the Commission considers that the effect of the aggregation is no more than minimal and that no competition concerns will exist in that market should the proposed acquisition occur.

The South Island Polystyrene Market

Market Concentration

80. An examination of market concentration may give a useful indication of whether a merged firm may be constrained by other participants, and thus on the extent to which it may be able to exercise market power.

81. On page 17 of the *Business Acquisitions Guidelines* 1999, the Commission states:

In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened, where, after the proposed acquisition, either of the following situations exists:

- the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market; or
- the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market, and faces competition from at least one other market participant having no less than in the order of a 15% market share.

82. Other things being equal, the higher the market share resulting from a business acquisition, the higher is the likelihood that dominance would be acquired or strengthened. However, conclusions cannot be drawn on market shares alone. As outlined above, the effect of section 3(9) of the Commerce Act is that market share is but one of a number of factors to be taken into account in reaching a view on dominance. The relative weight of these factors must be assessed in each market which is being examined, but the significance of market share could be outweighed by the other elements, especially the nature of entry conditions and the likelihood of entry.
83. James Hardie has estimated that it is responsible for about []% of New Zealand's polystyrene production and that Long International in the South Island, about []%. Long International, however, estimates that James Hardie

²⁴ See James Hardies' application for clearance for details.

has a [] in the South Island. Long Plastics Ltd which competes with James Hardie in the South Island wholesale polystyrene market also estimates that James Hardie and Long International []].

84. Glenroy is the third manufacturer of polystyrene blocks and sheet in the South Island. It is located in Blenheim. It manufactures polystyrene for use only in the Nelson and Marlborough areas. James Hardie estimates that Glenroy manufactures about []% of New Zealand's polystyrene. However, Glenroy estimates it manufactures about []% of the South Island's polystyrene. Glenroy is regarded as a significant presence in the market by other industry participants, although with old polystyrene manufacturing machinery which has lower production rates than those of James Hardie and Long International. In addition the owner/manager has been attempting to sell the business for four years and retire.
85. Polystyrene sales by each of the three South Island based companies are
- Long International \$[] per annum.
 - James Hardie \$[] per annum
 - Glenroy \$[] per annum
86. Using this information, the Commission estimates that the market shares of the three manufacturers of polystyrene blocks and sheets in the South Island are:
- James Hardie []%
 - Long International []%
 - Glenroy []%
87. If the proposed acquisition proceeds, the combined entity's market share [] will be very high and will exceed the Commission's upper guideline figure of 60%. However, as discussed above, market share is merely one indicator of dominance and other factors must be considered before any conclusions are reached.

Constraint from Existing Competition

88. Should the proposed acquisition proceed Glenroy will remain the only competitor in the market which the Commission has defined to consider the acquisition. The Commission has concluded that Glenroy does not offer a significant constraint throughout the market for the following reasons:
- although Glenroy has informed the Commission that it has the capacity to increase production to the level of Long International, its equipment is old and has lower production rates. For example Glenroy's machine produces 2.4 metre long blocks of polystyrene at a slower rate than IPDL produces 4.8 metre long blocks of equivalent or greater cross-sectional area;
 - Glenroy is a long established company manufacturing polystyrene and insulated panels. In earlier years it manufactured polystyrene for sale in

Christchurch and the North Island but the arrival of more efficient manufacturers in Christchurch and Palmerston North has led to it now manufacturing polystyrene for supply only to Marlborough and Nelson. Even in those areas where it has a transport cost advantage, the Christchurch manufacturers are able to supply, for example, Mitre 10 in Nelson with polystyrene sheet; and

- Glenroy has been on the market for four years. Its owner/manager wishes to retire. A number of industry participants have inspected the plant but there have been no takers.

Constraint from Potential Entry

89. The Commission considers that potential competition in the market, from new entry or expansion by existing market participants, can act as a constraint on behaviour in that market.
90. In assessing the constraint available from market entry, the Commission's approach is to consider whether the entry of new participants in response to the exercise of market power is likely, sufficient in extent, timely and sustainable. This is referred to as the "Lets" test. The application of the test to the South Island polystyrene market is as follows.

Likelihood and Sustainability of Entry

91. All industry sources spoken to have advised the Commission that barriers to entry into polystyrene production markets are low. This is evidenced by IPDL successfully entering the North Island polystyrene (and insulated panel) market four years ago in a plant located one kilometre from an established market participant²⁵. IPDL was able to enter both markets in 3½ months . [
-]
92. Long Plastics, the wholesaler and retailer of the entire polystyrene block and sheet output of Long International, currently has a [

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²⁵ Lanwood.

93. The Commission also considers that the number of small companies in the North Island market²⁶ which manufacture polystyrene in block and sheet form is indicative of the ease of entry into polystyrene manufacturing markets.

Extent

94. If it is to constrain market participants, the threat of entry must be to such an extent as to cause the market participants to react in a significant manner.

95. [

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96. Long Plastics already has an established customer base which extends to supply of builders' merchants throughout the South Island, to builders themselves in the Canterbury area and to retail purchasers in the Christchurch area.

Timeliness

97. To effectively constrain the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent. As a guide, the Commission considers that, for most markets, entry which cannot be achieved within two years from initial planning is unlikely to satisfy the timeliness requirement of the lets test. The Commission has noted, however, that the relevant time period has to be considered on a case-by-case basis.

98. IPDL successfully entered the polystyrene and insulated panel markets in the North Island in 3½ months . [

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99. The Commission considers these factors to be sufficient to allay any dominance concerns in this market.

²⁶ Along with James Hardie, Koolfoam, Styrobeck and Expol (see table 9.3 in James Hardie's application for clearance).

The South Island Insulated Panel Market

Market Concentration

100. There are also three participants in the South Island insulated panel market. Long International has stated that its turnover of insulated panels is \$[] million per annum and that James Hardie has []. Glenroy has estimated that it manufactures insulated panels whose value is about \$[] per annum. James Hardie has stated that its turnover of insulated panels at its Christchurch factory is \$[] million.
101. Based on these figures the Commission estimates that the market shares of the three manufacturers of insulated panel in the South Island are:
- James Hardie []%
 - Long International []%
 - Glenroy []%
102. However, these figures are complicated by the fact they include James Hardie and Long International's manufacture of both insulated panels and architectural cladding. The two companies do not differentiate between the two types of panel when calculating its sales figures. Indeed, as stated in James Hardie's application for clearance and confirmed by Long International, the latter company has been concentrating on the manufacture of architectural cladding for the last year. []
103. In spite of this difficulty in calculating market share in the South Island insulated panels market the Commission considers that if the proposed acquisition proceeds, the combined entity's market share [] will be very high and will exceed the Commission's upper guideline figure of 60%. However, as discussed above, market share is merely one indicator of dominance and other factors must be considered before any conclusions are reached.
104. Market participants expressed concerns to the Commission that should the proposed acquisition proceed, its increased market share and production would give James Hardie the ability to obtain much more favourably priced raw materials and that such an ability would lead to dominance in the market. BHP New Zealand Steel Ltd, the supplier of rolls of painted steel sheet for lamination onto the polystyrene sheets in the insulated panel manufacturing process, stated that it had a "price break" for customers who purchased more than [] tonnes of steel per annum. James Hardie was already above that level and the rest of the industry below that level. Secondly the Commission understands that polystyrene raw material may be obtained, competitively priced, from Australia, Korea, Germany and SE Asia. Further, Intermex Plastics Ltd, who is a broker of plastic raw materials from overseas, stated that James Hardie is a small purchaser of polystyrene raw material in comparison to overseas manufacturers and that the extra quantity James Hardie purchased

as a result of the proposed acquisition would make no difference to its purchasing price. The Commission considers the concerns of the market participants in this respect are unfounded.

Constraint from Existing Competition

105. Should the proposed acquisition proceed Glenroy will remain the only competitor in the market which the Commission has defined to consider the acquisition. The Commission has concluded that Glenroy does not offer a significant constraint throughout the market for the following reasons:
- it has a very small presence in the market;
 - the insulated panels which Glenroy produces have an older system for jointing between the panels. Glenroy's panels require the placement of an riveted insert to join panels together, whereas the insulated panels produced by all other manufacturers in New Zealand have a slip joint, whereby the panels are joined by pressure and held together by friction and require no riveting. As a result, Glenroy manufactured panels have a higher erection cost than those produced by the rest of the market participants; and
 - for the reasons described in the final two sub-paragraphs of paragraph 88.
106. Portacom NZ Ltd, as an on-going purchaser of insulated panels for the manufacture of portable buildings, said that both the North Island and South Island insulated panel markets are currently very competitive. It said that should the proposed acquisition proceed, it would not have immediate concerns in respect of price increases for insulated panels in the South Island because it had a []. However after that time it believed prices may rise unless someone else entered the market.

Constraint from Potential Entry

107. The Commission again has applied the “lets” test to the South Island insulated panels market as follows.

Likelihood and Sustainability of Entry

108. All market participants spoken to by Commission describe the market for the manufacture of insulated panels as intensely competitive with low margins. At present there is strong competition between Long International and James Hardie in the South Island market for insulated panels. Margins are tight. Under these conditions it appears to the Commission that entry is unlikely. However, should the proposed acquisition proceed and James Hardie raise its prices, entry appears much more likely. That is why [

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109. IPDL entered the North Island market insulated panels market (and polystyrene market) four years ago. It's part owner/manager was, at the time he took the decision to enter the market, the plant manager of Lanwood. IPDL is located one kilometre from Lanwood. As a result competition between the two companies has become fierce but, nevertheless, IPDL has survived and prospered. It has gained a market share approximately equal to that of the long standing business, Lanwood. [

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110. IPDL informed the Commission that the cost of a combined polystyrene and insulated panel plant would be between [] depending on the proportion of new and second hand equipment and on the amount of the working capital. The Commission considers this cost is not a high barrier to entry. Lanwood emphasised this point to the Commission by stating this is the type of market in which a few partners can enter by mortgaging their houses to obtain the necessary capital and that any such market must, by definition, have low barriers to entry. The Commission has been informed that there has been considerable rationalisation in the equivalent markets in Australia and that a potential entrant in the South Island has access to several second-hand panel machines which are for sale in that country at reasonable prices.

111. Arcus Holdings Ltd is not selling the design, build and manufacture part of the operations of Long International Ltd in the proposed acquisition. This department will be located within Arrow International Ltd and, given its considerable experience of the design, costing, manufacture and erection of insulated panels is expected to be a major purchaser in both the North and South Island insulated panel markets. This group was responsible for the management of the construction of the, recently completed, \$[] million Port of Wellington cold store. Long International has informed the Commission that should the proposed acquisition proceed [

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Extent

112. The South Island insulated panel market is presently not a market characterised by long term contracts²⁷. That is purchasers of insulated panels for most applications tend to be one-off purchasers who wish to construct a particular project. In this situation, there is the possibility for a credible, cost competitive entrant to gain as much market share as its production facilities allow.

Timeliness

113. IPDL successfully entered the insulated panel market in the North Island in 3½ months from the time decisions were taken to the time production began. [

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114. The Commission considers these factors to be sufficient to allay any dominance concerns in this market.

CONCLUSION ON THE APPLICATION FOR CLEARANCE

115. Having regard to the various elements of section 3(9) of the Act, and all other relevant factors, the Commission concludes that it is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.
116. Having made this decision, the Commission notes that, even though it is not presently clear whether or not Glenroy will remain a presence in the two markets examined by the Commission, this is a case where a very significant share of the two markets will be obtained by James Hardie if the acquisition proceeds. However, it also wishes to emphasise that this is a case where barriers to entry are particularly low requiring investment in relatively inexpensive, easily obtained machinery and an understanding of manufacturing processes which are not technically complicated. A purpose-built factory building is not required. Raw materials are easily obtainable. Further, there has been a recent example of successful entry into the relevant markets and that entry was able to be effected within a particularly short time. Moreover, the Commission has detected a real interest in entry into the relevant markets.

²⁷ [

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DETERMINATION ON NOTICE OF CLEARANCE

117. Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by James Hardie New Zealand Limited of the assets of Long International Ltd.

For the Commission

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J M Belgrave
Chairman

Dated this 15th day of December 2000